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IN THE

Supreme Court of the United States

ROBERT MARIANA, MICHAEL J. McFADDEN, KAREN M. MORAN, and EDWARD M. NANKERVIS,

Petitioners,

v.

D. MICHAEL FISHER, in his official capacity as Attorney General of the Commonwealth of Pennsylvania; and LARRY WILLIAMS, in his official capacity as Secretary of Revenue of the Commonwealth of Pennsylvania,

Respondents.

ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. If a State-sanctioned restraint of trade is not actively supervised by State officials and thus fails to satisfy the requirements of the *Parker v. Brown* state-action doctrine, can the *Noerr-Pennington* doctrine nonetheless immunize the restraint and its implementation by State officials from judicial scrutiny under the Sherman Act — in effect allowing the *Noerr-Pennington* doctrine to swallow up the *Parker* rule?

2. If state regulation at the manufacturer level results in higher prices that are passed on to consumers, do consumers have standing to challenge the regulation's constitutionality under the Commerce Clause and Compact Clause, particularly when the manufacturers have expressly waived their right to challenge the regulation and voluntarily agreed to its terms?

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Petitioners Robert Mariana, Michael J. McFadden, Karen M. Moran, and Edward M. Nankervis ("Petitioners") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at 338 F.3d 189 and is reprinted in Petitioner's appendix (Pet. App.) at 1a. The opinion of the district court (Pet. App. 34a) is reported at 226 F. Supp. 2d 575.

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on July 30, 2003. A timely petition for rehearing was denied on September 3, 2003. Pet. App. 61a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Constitution

> **Art. I, Section 8.** The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.
>
> **Clause 3.** To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Art. I, Section 10. No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

The Sherman Act

15 U.S.C. § 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.

State Statutes

The pertinent provisions of the Pennsylvania Tobacco Settlement Agreement Act 35 P.S. § 5672, *et seq.* are reproduced at Pet. App. 63a.

STATEMENT OF THE CASE

A. Procedural History

Petitioners, Pennsylvania consumers of tobacco products, commenced this action in the United States District Court, Middle District of Pennsylvania, pursuant to 28 U.S.C. § 1331, seeking declaratory and injunctive relief under the federal antitrust laws and the Constitution. Pet. App. 35a, 40-41a. Petitioners alleged that certain provisions of the multistate tobacco settlement agreement ("MSA") and the Pennsylvania Tobacco Settlement

Agreement Act, 35 P.S. § 5672, *et seq.* ("TSAA"), violate the Sherman Act, 15 U.S.C. § 1, and the Constitution's Commerce Clause and Compact Clause. Const., Art. I, § 8, cl. 3, Art. I, § 10. *Id.* Respondents, D. Michael Fisher and Larry Williams, are the Commonwealth officials responsible for implementing and enforcing the MSA and TSAA in Pennsylvania. Pet. App. 35a.

On appeal from the District Court's order and judgment dismissing Petitioner's claims pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, the Court of Appeals held that Petitioners' complaint indeed stated a claim for relief under the federal antitrust laws. Specifically, Petitioners sufficiently alleged that certain provisions of the MSA and TSAA — in particular, those that restrict competition by causing competitors of the major tobacco manufacturers to limit their output and raise prices — restrain trade in violation of the Sherman Act. Pet. App. 11a. With these restraints in place, and free from the competitive forces that otherwise would have prevailed in the marketplace, the major manufacturers (who negotiated the MSA and drafted the TSAA) were able to, and did, raise their prices to levels well in excess of that needed to fund their MSA payments. Pet. App. 40a. The Court of Appeals accepted Petitioners' allegations that the resulting price increases have been and continue to be passed on to consumers, including Petitioners, who have suffered injury to their person and property by reason of these antitrust violations. Pet. App. 4a.

The Court of Appeals also held that the restraints of trade contained in the MSA and TSAA, and Respondents' implementation and enforcement of them, do not satisfy the requirements of the state action doctrine enunciated by the Court in *Parker v. Brown*, 317 U.S. 341 (1943), and its progeny. Pet. App. 26a. Petitioners alleged facts demonstrating that Respondents and State officials of the

remaining States that entered into the MSA do not actively supervise the private anticompetitive conduct made by possible by, and resulting from, these restraints of trade. Pet. App. 25a. Significantly, however, the Court of Appeals concluded that the *Noerr-Pennington*[1] immunity doctrine nonetheless precluded Petitioners from challenging the restraints under the Sherman Act. Pet. App. 19a-20a.

According to the Court of Appeals, the *Noerr-Pennington* doctrine shields Respondent Fisher from liability with respect to his petitioning of the Commonwealth courts to accept the MSA and the Pennsylvania legislature adopt the TSAA. *Id.* Respondent Fisher's *Noerr-Pennington* immunity, the Court of Appeals reasoned, must extend beyond such petitioning activity and serve also to immunize the restraints themselves as well as their implementation by Respondent Fisher, notwithstanding that the restraints and their implementation by Commonwealth officials fail to satisfy the state action doctrine. Pet. App. 17a-18a. The Court of Appeals observed: "If we were writing on a clean slate, we might find some logic in [Petitioners'] argument that conduct of private parties must be evaluated under *Noerr-Pennington* and that of government units under *Parker*. But the slate is not *tabula rasa*." Pet. App. 12a.

Petitioners' Commerce Clause and Compact Clause claims alleged in principal that the MSA and TSAA unlawfully interfere with the exclusive authority of Congress to regulate interstate commerce and to approve multistate compacts that tend to encroach upon the power of the federal government, including the power to regulate interstate commerce. Pet. App. 52a. As described in further detail

1. *Eastern R. Pres. Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1960); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

below, the purpose and effect of the MSA and TSAA's regulatory scheme was and is to regulate and unduly burden the entire interstate domestic tobacco market, which has caused consumers, including Petitioners, to pay exorbitant and uniformly higher prices — indeed, at levels far greater than that needed to fund the payments required under the MSA. *Id.*

Without reaching the substantive merits, and notwithstanding that the issue was never raised in the District Court or by Respondents on appeal, the Court of Appeals dismissed Petitioners' constitutional claims on jurisdictional grounds, finding that Petitioners alleged no concrete injury and merely alleged injury to competitors of the major manufacturers.[2] Pet. App. 30a-32a. In short, the Court of Appeals held that Petitioners do not have standing to raise their constitutional claims and affirmed the District Court's dismissal of these claims, accordingly.

Petitioners timely requested rehearing and rehearing *en banc* of the panel's decision. Pet. App. 61a-62a. Petitioners sought to bring to the attention of the Court of Appeals that the Panel's denial of standing on the constitutional claims conflicted with the decisions of the Court in *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), and *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276 (1984), and the decision of the Court of Appeals for the Six Circuit in *Huish Detergents, Inc. v. Warren Cty.*, 214 F.3d 707 (6th Cir. 2000). Petitioners also sought rehearing with respect to their Sherman Act claims. Since the establishment of the *Parker* state action

2. The District Court summarily held that Petitioners could prove no set of facts that the MSA violates the Commerce Clause or Compact Clause. The District Court, like the Court of Appeals, also concluded that Petitioners' constitutional challenges were directed solely at the MSA, not the TSAA.

doctrine and the Court's first acknowledgment of *Noerr-Pennington* immunity principles, no court has held that *Noerr-Pennington* immunity can shield from antitrust scrutiny a restraint of trade that fails to satisfy the requirements of the state action doctrine. The Court of Appeals denied Petitioners' request for rehearing on September 3, 2003. *Id.*

B. Pertinent Facts

In November 1998, forty-six states ("MSA States"), including the Commonwealth of Pennsylvania, and the four largest U.S. tobacco product manufacturers ("Majors") entered into the MSA.[3] Pet. App. 35a. Under the MSA, the Majors agreed to make multi-billion dollar annual settlement payments to the MSA States and, *inter alia*, curb certain of their pre-MSA marketing practices. Pet. App. 4a. In return for these concessions and as a condition to accepting the settlement, the Majors demanded that the MSA States, in turn, agree to limit the increased competition that the Majors would likely face subsequent to the MSA's execution, when they raised their prices to fund the MSA's annual payments. Pet. App. 37a-38a. Heeding the Majors' demands, the MSA was ultimately structured and drafted to include certain restraints of trade that Petitioners allege have the express purpose and effect of limiting competition from the Majors' competitors. *Id.*

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3. The Majors are Philip Morris Inc. ("Philip Morris"), R.J. Reynolds Tobacco Company ("RJR"), Brown & Williamson Tobacco Corp. ("B&W"), and Lorillard Tobacco Company ("Lorillard"). The MSA settled claims asserted by the MSA States that arose out of the Majors' alleged breaches of common law and statutory duty in connection with the sale and marketing of their products. Pet. App. 36a-37a.

Under the MSA's "Renegade Clause" provisions, manufacturers whose cigarettes were sold in the United States in 1997 or 1998 (other than the Majors) were given the *option* of joining the MSA and "settling" with the MSA States as "Subsequent Participating Manufacturers" or "SPMs," despite the fact that no MSA State had ever asserted a claim or brought suit against these manufacturers.[4] Pet. App. 4a. Recognizing that manufacturers that were never sued nor accused of any wrongdoing had little or no incentive to join the MSA, the MSA States and Majors offered SPMs an annual payment exemption under the MSA as an inducement to join. Pet. App. 5a-6a. To benefit fully from the payment exemption, however, the SPMs had to agree, in any year subsequent to 1998, not to exceed their respective pre-MSA market shares. Specifically, the Renegade Clause states that each SPM that entered into the MSA within ninety days of its execution date is not required to make any MSA payment to the MSA States, *provided the SPM's U.S. market share in any year subsequent to 1998 does not exceed 125% of its 1997 U.S. market share or 100% of its 1998 U.S. market share, whichever is greater. Id.*

In addition to the Renegade Clause, the Majors and MSA States also agreed to, and drafted, model legislation annexed as Exhibit "T" to the MSA, which was intended by the parties to be enacted (and has been enacted) in each of the MSA States. Pet. App. 38a-39a. In Pennsylvania, the model legislation was enacted as the TSAA. The TSAA and its model legislation counterparts in the remaining MSA States are commonly known as the "Escrow Statutes." The MSA recites that the purpose of the Escrow Statutes is to "effectively and fully neutralize[] the cost disadvantages that

4. The Majors are identified in the MSA as "Original Participating Manufacturers" or "OPMs."

the [Majors and SPMs] experience *vis-à-vis* Non Participating Manufacturers within each [MSA State] as a result of the provisions of [the MSA]." Pet. App. 4a-5a. A Non Participating Manufacturer ("NPM") under the MSA and TSAA is any tobacco product manufacturer that does not join the MSA as an OPM or SPM.

Under the TSAA, every manufacturer whose cigarettes are sold in Pennsylvania must join the MSA as an SPM, or remain an NPM and establish a Qualified Escrow Fund for Pennsylvania's benefit that must be funded annually based on the number of the NPM's cigarettes sold in the Commonwealth and nationally. Pet. App. 64a-66a. The minimum amount that an NPM must maintain in escrow under the TSAA for a given year is equal to that which Pennsylvania would have received from the NPM for that year had it joined the MSA as an SPM without a market share exemption. Pet. App. 66a. The funds deposited must be held for twenty-five years and can be accessed before then only by the Commonwealth, to satisfy a judgment that it might recover against the NPM on a Released Claim (defined in the MSA) in the event the Commonwealth sues the NPM and the NPM settles or is judicially determined to have acted culpably. Pet. App. 66a-67a.

In 1998, the Majors accounted for 96% - 98% of the U.S. market in cigarette sales. Pet. App. 2a. Confronted with the option of making annual payments as SPMs under the MSA only if they exceeded their market share exemption under the Renegade Clause, or alternatively making annual escrow payments under the Escrow Statutes based on every cigarette they sold, almost all of the remaining manufacturers in the U.S. market opted to join the MSA as SPMs. Pet. App. 39a. With the U.S. market, other than that portion possessed by the Majors, subject to the Renegade Clause's market share restrictions and "competition-

neutralizing" Escrow Statutes, the empirical effect of this regulatory scheme agreed to by the Majors and MSA States has been consistent conventional economic wisdom and traditional antitrust jurisprudence.

SPMs cannot maintain pre-MSA price levels for their generic cigarettes, in the face of the Majors' post-MSA price increases. If they do, the increased demand in their products *vis-a-vis* the Majors' products would cause these SPMs quickly to surpass their 1997-1998 market share caps under the Renegade Clause and, in turn, incur *pro rata* liability for the MSA's multi-billion dollar annual payments. Pet. App. 10a. Industry profit margins on generic cigarettes simply would not allow SPMs to absorb such liability without raising prices. Thus, SPMs are, and have been, forced to raise their prices post-MSA to levels that are choreographed and controlled solely by the Majors. *Id.* Similarly, the current escrow obligation of an NPM is approximately $.39 per pack, which corresponds to the approximate amount it would otherwise pay as an SPM under the MSA without an exemption. Pet. App. 65a-66a. The escrow payments (like the MSA payments of an SPM that exceeds its market share allocation) are greater than pre-MSA per pack profit levels for generic cigarettes. Thus, an NPM, too, must raise its prices if it wishes to stay in business. Pet. App. 38a. It cannot maintain pre-MSA price levels for its products and fund the escrow payments required by the TSAA. Thus, and by design, the foregoing regulatory scheme limits the output of the Majors' competitors and their ability to offer meaningful price competition in the face of the Majors' exorbitant price increases. Pet. App. 37a.

With the MSA and TSAA's restraints in place, the Majors have subjected consumers, including Petitioners, to unbridled price-gouging. For example, prior to the MSA's execution

on November 23, 1998, the parties to the MSA, including Respondent Fisher, projected that, in four years, the Majors would raise their price for cigarettes by $.35 - $.40 per pack, to finance their settlement payments under the MSA. Within just forty-eight hours of the MSA's execution, however, the Majors raised their prices in unison by $.45 per pack. Pet. App. 40a. To date, the anticompetitive restraints in the MSA and TSAA have allowed the Majors to raise their prices uniformly by more than $1.00 per pack — an amount greater than 300% of that which was and is necessary to finance their MSA payments, annually — all of which has been passed on to consumers, including Petitioners. Pet. App. 36a.

REASONS FOR GRANTING THE PETITION

1. The holding of the Court of Appeals with respect to the *Noerr-Pennington* doctrine, particularly given its findings with respect to state action, is unprecedented and in irreconcilable conflict with the decisions of this Court and other Courts of Appeals applying these antitrust immunity rules.

In a case that dealt with state regulation of wine producers and sellers, the Court, in *California Retail Liq. Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), struck down California legislation that failed to satisfy the requirements of the state action doctrine, because the State of California and, specifically, its officials did not actively supervise the anticompetitive conduct that the legislation sanctioned. The legislation effectively permitted wine producers to maintain higher wholesale prices and retail price levels for their products in the relevant market. The Court observed that the legislation provided for no oversight or mechanism through which State officials might pointedly reexamine, curb or control the anticompetitive conduct (price setting) that

resulted from the State's regulation, nor did State officials otherwise exercise such supervision or control.[5]

Significantly, the Court in *Midcal* did not hold or suggest that the California legislation was, or could be, immune from Sherman Act scrutiny simply because California wine producers petitioned the California Assembly to pass such legislation and were shielded from liability under the *Noerr-Pennington* doctrine with respect to their lobbying for the legislation. *See* Philip E. Areeda & Herbert Hovenkamp, *Antitrust Law* § 229 (2002 Supp.) (hereafter "*Areeda & Hovenkamp*"). Indeed, the fact that a person petitions a branch of state government to adopt regulation that restrains trade has never been grounds to immunize the regulation adopted, nor its subsequent implementation, particularly when anticompetitive conduct sanctioned by the regulation is not actively supervised by State officials and fails to satisfy the state action doctrine.

The *Noerr-Pennington* doctrine protects persons from liability when they petition a state government to adopt a restraint of trade; the state action doctrine — and only the

5. In *Midcal*, this Court established a two-pronged test that is to be applied when reviewing state regulation that permits or results in private anticompetitive conduct: "First, the challenged restraint must be one clearly articulated and affirmatively expressed as state policy; second, the policy must be actively supervised by the State itself." 445 U.S. at 105 (internal quotes omitted). As the Court later explained, this test applies also to state officials regulating private parties. "The circumstances in which *Parker* immunity is available to . . . state agencies or officials regulating the conduct of private parties, are defined most specifically by our decision in [*Midcal*]. In that case, we were concerned, as we are here, with state regulation restraining competition among private parties." *Southern Motor Carriers Rate Conf. v. United States*, 471 U.S. 48, 57-58 (1985).

state action doctrine — governs whether the restraint and its subsequent implementation by State officials is subject to judicial scrutiny under the Sherman Act. "*Parker* protects the States' act of governing, and *Noerr* the citizens' participation in government." *Columbia v. Omni Outdoor Adver. Inc.*, 499 U.S. 365, 383 (1991); *In re Airport Car Rental Antitrust Litig.*, 693 F.2d 84, 87 (9th Cir. 1982) (when state official and private parties are sued, liability of state official governed by *Parker*).[6] To hold otherwise, as the Court of Appeals did below in this case, would eviscerate the state action requirements of *Parker* and *Midcal*.

Moreover, that a state-sanctioned restraint of trade is embodied in a settlement agreement with a State official, rather than legislation, cannot change the relevant analysis or result. No exception to the two-pronged test established in *Midcal* exists for restraints adopted or agreed to in the context of a settlement, nor is there any sound policy reason for advocating in favor of such an exception. Indeed, a contrary rule would accord settlement agreements —

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6. *See also TFWS, Inc. v. Schaefer*, 242 F.3d 198, 204 (4th Cir. 2001) (state comptroller and other state officials enjoined from enforcing state regulations that failed active supervision test); *Nursing Registry, Inc. v. Eastern North Carolina Reg. Emer. Med. Servs.*, 959 F. Supp. 298 (E.D.N.C. 1997) (*Noerr-Pennington* and state action are analytically distinct; claims against private parties analyzed under *Noerr*, and claims against government officials analyzed under *Parker*); *Bright v. Ogden City*, 635 F. Supp. 31, 33 (D. Utah 1985) (state action doctrine and *Noerr-Pennington* doctrines are separate, and State may lack state action immunity even when private actors are immune from liability under *Noerr*); Philip E. Areeda & Herbert Hovenkamp, § 229 (2d ed. 2000) (*Noerr* governs petitioning of the government; *Parker* governs the subsequent governmental supervision of the restraint).

including those entered into with State officials — an immunity status greater than that accorded duly enacted state legislation, which is immune from scrutiny under the Sherman Act only if its satisfies the two-pronged test announced in *Midcal*. Immunizing a restraint of trade among private parties, as the Court of Appeals did in this case, based merely on the fact that a state official agreed to the restraint in the context of settling a lawsuit violates the long established rule that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." *Parker*, 317 U.S. at 351.[7]

2. Dismissal of Petitioners' constitutional challenges to the MSA and TSAA on standing grounds flies in the face of the Court's decision in *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), and similar Circuit Court precedent acknowledging that consumers who pay higher prices as a result of unconstitutional state regulation suffer injury that is within the 'zone of interests' protected by the Commerce Clause.

In holding that Petitioners as consumers lacked standing to challenge the constitutionality of certain provisions of the MSA and TSAA, the Court of Appeals construed Petitioners to be interposing a claim derivative to that of SPMs and NPMs who are restrained from increasing output or lowering

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7. *See also Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979). "Of course, a consent judgment [and settlement agreement], even one entered at the behest of the Antitrust Division, does not immunize [defendants] from [antitrust] liability for actions, including those contemplated by the [consent] decree, that violate the rights of nonparties." 441 U.S. at 13.

their prices in the relevant market. Thus, the Court of Appeals ruled:

> [Petitioners] do not complain that the MSA's payment structure injures them as smokers. Because [Petitioners] are not asserting their own legal interests but instead those of third parties — here the SPMs and NPMs — they are not analogous to the plaintiffs in *Oxford Assocs.* [*v. Waste System Auth.*, 271 F.3d 140 (3d Cir. 2001)], who alleged that they personally were injured by the fee structure at issue in that case.

Pet. App. 31a.

In reaching the foregoing conclusion, the Court of Appeals disregarded that "[a]t the pleading stage, general factual allegations of injury . . . may suffice, for on a motion to dismiss we presum[e] that general allegations embrace those specific facts that are necessary to support the claim." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992) (internal quotation marks and citation omitted). In this regard, Petitioners' allegations of injury derive not from the injury suffered by SPMs and NPMs but, rather, the injury Petitioners suffered and continue to suffer in their own right by reason of having to pay higher prices resulting from the subject state regulation.

The Court in *Tracy* made it abundantly clear that "cognizable injury from unconstitutional [regulation of] interstate commerce does not stop at members of the class . . . whom a State ultimately [regulates], and customers of that class may also be injured." 519 U.S. at 286; *see also Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (wholesalers had standing to raise Commerce Clause challenge to Hawaii tax regime, although wholesalers were

not among class of out-of-state liquor producers allegedly burdened by Hawaii's law). The rationale and decision in *Tracy* affording standing to consumers to challenge the constitutionality of state regulation at the producer level has been followed also by the Court of Appeals for the Six Circuit, in *Huish Detergents, Inc. v. Warren Cty.*, 214 F.3d 707 (6th Cir. 2000), and should have been adhered to in this case.

Much like the individual waste generators in *Huish*, Petitioners alleged directly and not through conjecture that *they* pay higher prices for products because of the undue and direct burden the MSA and TSAA places on interstate commerce. Petitioners' injury is not derivative of SPMs or NPMs, particularly insofar as Petitioners' injury stems from the price increases instituted by the *Majors* that resulted from the subject regulation. Moreover, in interpreting these facts to reflect that Petitioners are asserting the legal interest of SPMs, the decision below fails to accord with the fact that SPMs who stay within their market allocation — and those (similar to NPMs) who simply pass on the cost of the regulation — have no economic interest in challenging the constitutionality of the MSA or TSAA and, more importantly, expressly waived their right to challenge the constitutionality of the MSA.

In cases such as this involving a constitutional claim, a plaintiff must satisfy two tests for standing: first, it must meet basic Article III constitutional requirements; and second, the plaintiff's injury must fall within the 'zone of interests' protected by the constitutional guarantee. To establish Article III standing, a plaintiff must demonstrate: (1) an injury in fact that is actual or threatened; (2) a causal connection between the defendants' conduct and the alleged injury; and (3) a substantial likelihood that the injury will be redressed

by a favorable decision. *Lujan*, 504 U.S. at 560-61. Petitioners have alleged each of the required elements for standing under Article III, and the Court of Appeals should not have found otherwise. Petitioners "alleged an actual injury as a result of the [Commonwealth's TSAA] and agreement with [the Majors and SPMs], in consequence of which [Petitioners are] forced to pay [the Majors, SPMs and NPMs] more to [purchase their products] than [Petitioners] would spend if [they] could purchase" these products without the infringing regulation. *Huish*, 214 F.3d at 710.

Petitioners also satisfy the prudential limitations on standing, by showing that the interest they seek to protect "arguably fall[s] within the zone of interests protected or regulated by the statutory provision or constitutional guarantee invoked in the suit." *Bennett v. Spear*, 520 U.S. 154, 162 (1997). In this case, the constitutional guarantees at issue arise under the Commerce Clause and Compact Clause, which are designed to prevent States from regulating interstate commerce and from overarching and encroachment upon the federal government's supremacy in this area. The Commerce Clause protects not only producers, but also consumers like Petitioners who "'may look to the free competition from every producing area in the Nation to protect [them] from exploitation by any.'" *Dennis v. Higgins*, 498 U.S. 439, 450 (1991) (quoting *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 539 (1949)).

Petitioners allege that forty-six States have entered into a multistate agreement and enacted model legislation that expressly regulates tobacco sales in all fifty States. A manufacturer whose products are sold in Pennsylvania must enter into a settlement agreement with the Commonwealth and forty-five other States, pursuant to which it must pay all

forty-six States damage payments based on its sales nationwide. Pet. App. 64a. Alternatively, the manufacturer must make annual escrow payments based on what it would have paid the Commonwealth had it joined the MSA, *i.e.*, again, based on its sales nationwide — not just in Pennsylvania. Pet. App. 66a. Thus, and by design, a manufacturer selling its products in Pennsylvania must take into account not only the prices it can charge in the Commonwealth but, rather, its sales in each and every State and the affect of such sales on its MSA or escrow liability to Pennsylvania. The clear purpose and effect of such regulation is to burden and regulate interstate commerce in and among the fifty States, and the unequivocal result is higher prices passed on to consumers, including Petitioners. *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989); *Brown-Forman Dist. Corp. v. New York State Liq. Auth.*, 476 U.S. 573, 582-83 (1986). Petitioners submit that their injury in the form of higher prices resulting from this regulation is well within the zone of interests protected by the Commerce Clause and Compact Clause. *See Tracy*, 519 U.S. at 286-87.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DECIDED JULY 30, 2003

UNITED STATES COURT OF APPEALS
THIRD CIRCUIT

No. 02-2906

Robert MARIANA; Michael J. McFadden; Karen M. Moran; Edward M. Nankervis,

Appellants

v.

D. Michael FISHER, in his official capacity as Attorney General of the Commonwealth of Pennsylvania; Larry Williams, in his official capacity as Secretary of Revenue of the Commonwealth of Pennsylvania.

Argued March 12, 2003

Decided July 30, 2003

Before: SLOVITER, NYGAARD, and ALARCÓN,* Circuit Judges.

OPINION OF THE COURT

SLOVITER, Circuit Judge.

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* Hon. Arthur L. Alarcón, Senior Judge, United States Court of Appeals for the Ninth Circuit, sitting by designation.

Appendix A

This appeal presents us with yet another round of litigation surrounding the multi-billion dollar national tobacco settlement, known as the Master Settlement Agreement ("MSA").[1] In 1998, the M.S.A. was entered into between 46 States and the four largest domestic tobacco companies that together made 98% of cigarette sales in the United States at that time, referred to as the "Majors."[2] Plaintiffs Robert Mariana, Michael McFadden, Karen Moran and Edward Nankervis, all Pennsylvania residents who smoke cigarettes, filed suit claiming that certain provisions of the M.S.A. violate Section 1 of the Sherman Act, 15 U.S.C. § 1, the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, and the Compact Clause, U.S. Const. art. I, § 10, cl. 3, of the United States Constitution.

In their complaint, Plaintiffs sued Larry Williams, Pennsylvania's Secretary of Revenue, and Michael Fisher,

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1. This suit is just one in a series attacking the M.S.A. § and statutes passed pursuant to it. Thus far, these suits have been unsuccessful. *See Star Scientific, Inc. v. Beales*, 278 F.3d 339 (4th Cir.), *cert. denied sub nom. Star Scientific, Inc. v. Kilgore*, 537 U.S. 818, 123 S.Ct. 93, 154 L.Ed.2d 24 (2002); *A.D. Bedell Wholesale Co., Inc. v. Philip Morris Inc.*, 263 F.3d 239 (3d Cir.2001), *cert. denied*, 534 U.S. 1081, 122 S.Ct. 813, 151 L.Ed.2d 697 (2002); *PTI, Inc. v. Philip Morris Inc.*, 100 F.Supp.2d 1179 (C.D.Cal.2000); *Hise v. Philip Morris Inc.*, 46 F.Supp.2d 1201 (N.D.Okla.1999), *aff'd mem.*, 208 F.3d 226 (10th Cir.), *cert. denied*, 531 U.S. 959, 121 S.Ct. 384, 148 L.Ed.2d 296 (2000); *Forces Action Project LLC v. California*, No. C99-0607 MJJ, 2000 WL 20977 (N.D.Cal. Jan.5, 2000), *aff'd in part, rev'd in part*, 16 Fed.Appx. 774 (9th Cir.2001).

2. The Majors consist of Philip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard Tobacco.

the Attorney General of Pennsylvania in their official capacities. We note that the Majors are not named defendants in this particular litigation as this court concluded in an earlier decision that the Majors were immune from antitrust liability under the *Noerr-Pennington* doctrine. *See A.D. Bedell Wholesale Co., Inc. v. Philip Morris Inc.*, 263 F.3d 239 (3d Cir.2001), *cert. denied*, 534 U.S. 1081, 122 S.Ct. 813, 151 L.Ed.2d 697 (2002).

The District Court dismissed the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), and Plaintiffs appeal.

I.

FACTS AND PROCEDURAL HISTORY

A comprehensive history of the M.S.A. can be found in *Bedell* and will be repeated here only to the extent necessary for the discussion and analysis. The M.S.A. was negotiated after various lawsuits were either brought or threatened against the Majors and other tobacco companies by States seeking to recover Medicaid funds that they spent to treat tobacco-related diseases. Pennsylvania filed suit against the Majors in April 1997 and the suit was settled as part of the MSA.[3]

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3. Initially, the States and the Majors asked Congress to resolve the suits through a national legislative remedy. The M.S.A. was executed by the parties only after congressional efforts failed. *Bedell*, 263 F.3d at 241.

Appendix A

Under the MSA, the Majors agreed to pay the settling States billions of dollars and to restrict their marketing of cigarettes, one of the practices complained about in the States' lawsuits. In return, the M.S.A. included provisions designed to enable the Majors to transfer billions of dollars to the States, provisions that the Plaintiffs allege were to be funded by the payment by wholesalers and consumers of artificially high prices for cigarettes. Plaintiffs further contend that after the M.S.A. was entered into, the prices charged by the Majors have generated revenue much greater than needed to fund the M.S.A. and have enabled the Majors to spend record amounts on advertising.

After the execution of the MSA, additional tobacco manufacturers representing 2% of the market joined the settlement as Subsequent Participating Manufacturers ("SPMs"). That joinder meant that nearly all of the domestic cigarette producers had signed the MSA. *Bedell*, 263 F.3d at 243.

The addition of the SPMs was significant, as the Majors allegedly had feared that cigarette manufacturers who had been left out of the M.S.A. would be able to expand their market share or enter the market by offering lower prices. *Id.* The M.S.A. is explicit that its purpose is to reduce the ability of non-signatory cigarette manufacturers to gain market share due to the competitive advantage gained by not contributing to the multi-billion dollar settlement. *Id.* at 246. Indeed, the M.S.A. declares that it "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating

Manufacturers with such Settling States as a result of the provisions of this Agreement." MSA § IX(d)(2)(E).

On January 10, 2002, Plaintiffs filed this suit against the Pennsylvania Attorney General and the Secretary of Revenue, in their official capacities, seeking injunctive relief from the continued implementation, enforcement and performance of the M.S.A. on behalf of Pennsylvania. Plaintiffs claim that a major objective of the M.S.A. is to prevent SPMs and Non-Participating Manufacturers ("NPMs") from expanding their market share and to prevent new or potential competitors from entering the market. Specifically, they challenge the MSA's so-called "Renegade Clause," the settlement's primary mechanism for allocating payment responsibilities based on production levels, and the MSA's provision calling for enactment by the settling States of "Qualifying Statutes," laws requiring NPMs to make payments into state escrow accounts for each sale made. *See Bedell*, 263 F.3d at 243. Pennsylvania's Qualifying Statute, the Tobacco Settlement Agreement Act ("TSAA"), 35 Pa.Stat. § § 5672-5674 (2003), requires each NPM either to become a signatory to the M.S.A. as an SPM or to make payments into an escrow account fund to be held to pay any judgment or settlement that the Commonwealth secures in subsequent litigation against the NPM. 35 Pa. Cons.Stat. § 5674(a) and (b)(1). The payments are to be returned to the NPM after 25 years if they are not needed to pay judgments or settlements. 35 Pa. Cons.Stat. § 5674(b)(3).

The Renegade Clause provides that the SPM need not make payments to the States under the M.S.A. as long as the market share of an SPM does not exceed the greater of its

1998 market share or 125% of its 1997 market share. MSA IX(I). This mechanism allegedly discourages SPMs from underpricing the Majors to increase their market share, even if they could do so efficiently. *See Bedell*, 263 F.3d at 244. This provision, the Plaintiffs claim, effectively puts a market share cap on SPMs and restricts their output.

Similarly, if NPMs, including potential new entrants into the market, gain market share, thereby reducing the Majors' market share, the Majors may decrease their payments to the settlement fund. *Bedell*, 263 F.3d at 244. The Qualifying Statute requires that the NPMs choose between joining the MSA, thereby subjecting themselves to the same restrictions on market share as SPMs, or be subject to tobacco related lawsuits for which they must make payments into the State established escrow account for any potential adverse judgments. *Id.* at 246. The M.S.A. § also creates a $50 million Enforcement Fund provided by the Majors to investigate and sue NPMs to enforce the settlement. *Id.* at 245-46.

According to Plaintiffs, economics force SPMs to join the scheme while new entry is precluded. This enables the Majors to cling to their 98% market share, thereby creating an unregulated cartel. Plaintiffs claim that this output cartel has allowed and continues to allow the Majors to raise prices to artificially high and supracompetitive levels without fear of significant competition and without any monitoring, regulation, or active supervision by the States. In fact, Plaintiffs allege that since the execution of the MSA, the Majors have raised wholesale prices of cigarettes by nearly 60% while losing less than 5% of their market share. This, according to Plaintiffs, is a violation of the Sherman Act.

Finally, Plaintiffs allege that the M.S.A. violates the Commerce and Compact Clauses of the U.S. Constitution.

In dismissing the antitrust claims asserted in the complaint, the District Court held that in light of *Bedell*, Defendants, like the Majors, enjoy *Noerr-Pennington* immunity. It further found that Plaintiffs could prove no set of facts that would establish violations of the Commerce and Compact Clauses of the United States Constitution. Plaintiffs timely appealed. Forty states, the District of Columbia, and the Northern Mariana Islands, all parties to the MSA, have filed an amicus brief urging us to affirm the order of the District Court.

II.

JURISDICTION AND STANDARD OF REVIEW

We have jurisdiction to hear this appeal pursuant to 28 U.S.C. § 1291. We exercise de novo review over the dismissal of claims under Federal Rule of Civil Procedure 12(b)(6). *Bedell*, 263 F.3d at 249 n. 25. Furthermore, we must take all factual allegations and reasonable inferences as true and view them in the light most favorable to Plaintiffs. *Id.* The District Court properly dismissed Plaintiffs' complaint only if Plaintiffs could have proved no set of facts entitling them to relief. *Id.*

Appendix A

III.

ANTITRUST CLAIM

As an initial matter, we consider whether Plaintiffs properly have stated a cause of action under the Sherman Act.[4] Defendants argue that Plaintiffs fail to state a claim as the M.S.A. does not establish an output cartel in violation of the Sherman Act. The vigor with which Defendants argued this issue came as a surprise to us as *Bedell* clearly forecloses their argument. *See Bedell*, 263 F.3d at 249-50. During oral argument, Attorney General Fisher, who argued on behalf of both Defendants, conceded that the facts and allegations in this case are "virtually similar" to those in *Bedell.* Tr. of Oral Argument, Mar. 12, 2003, at 20. Nonetheless, he contended that the *Bedell* court based its findings on the *Bedell* plaintiffs' characterization of the M.S.A. rather than the M.S.A. itself. According to General Fisher, we must consider both Plaintiffs' allegations and the M.S.A. itself. This, however, is precisely what the *Bedell* court did as evidenced by the various times it quoted actual sections of the MSA. *E.g.*, *id.* at 244 nn. 17-19. Even a cursory reading of *Bedell* discredits Defendants' argument, which we now reject. Thus, it is to *Bedell* itself that we now turn.

Plaintiff in *Bedell* was a cigarette wholesaler that brought a class action suit against the Majors on behalf of itself and 900 similarly situated wholesalers. Like the Plaintiffs in the

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4. Under § 1 of the Sherman Act, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal." 15 U.S.C. § 1.

case before us, the *Bedell* plaintiffs alleged that the MSA's Renegade Clause and Qualifying Statutes created an output cartel, thereby violating the Sherman Act. The district court dismissed the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), and the plaintiffs appealed. Before reaching the defendants' arguments on immunity, this court considered — and rejected — the argument that the terms of the M.S.A. do not constitute an agreement to limit output in violation of the antitrust laws. We stated: "An agreement which has the purpose and effect of reducing output is illegal under § 1 of the Sherman Act." *Id.* at 247. We cited *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 777, 119 S.Ct. 1604, 143 L.Ed.2d 935 (1999), where the Court discussed the effects of anticompetitive output restrictions and *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 99, 104 S.Ct. 2948, 82 L.Ed.2d 70 (1984), where the Court stated that "the challenged practices create a limitation on output; our cases have held that such limitations are unreasonable restraints of trade."

We noted further,

> The Court has made clear that a pure restriction on output is anticompetitive and in the absence of special circumstances, would violate the antitrust laws. *NCAA*, 468 U.S. at 85, 104 S.Ct. 2948, 82 L.Ed.2d 70 (recognizing that output restrictions may be permissible if required in order to market the product at all). By limiting production, the cartel is able to raise prices above competitive levels.

Bedell, 263 F.3d at 248.

We pointed out that the Federal Trade Commission/ Department of Justice Guidelines also recognize that agreements to reduce output violate the antitrust laws. *Id.* Applying those general principles to the MSA, we stated,

> Plaintiffs allege the agreement between the States and the Majors purposefully creates powerful disincentives to increase cigarette production. Although the Multistate Settlement Agreement contains no explicit agreement to raise prices or restrict market share, any signatory who increases production beyond historic levels automatically will increase its proportionate share of payments to the Multistate Settlement Agreement. Normally, a company which lowers prices would be expected to increase market share. But the penalty of higher settlement payments for increased market share would discourage reducing prices here. For this reason, signatories have an incentive to raise prices to match increases by competitors. It appears this incentive structure has proven true. The Majors' prices increased dramatically and simultaneously after signing the Multistate Settlement Agreement.

Id. at 248-49.

After noting that plaintiffs had alleged that defendants formed an output cartel through the M.S.A. that restricts production and effectively bars entry to the cigarette tobacco

market and that the defendants injured the tobacco wholesalers by charging artificially high prices, the court, speaking through Judge Scirica, stated, "[w]e *hold* that plaintiffs have properly pleaded an antitrust violation by alleging defendants agreed to form an output cartel through the [MSA] that violates § 1 and § 2[ ] of the Sherman Antitrust Act." *Id.* at 249-50 (emphasis added) (footnote omitted). That was the *holding* of the court and General Fisher's attempt to argue to the contrary is without basis. The holding was critical to our conclusion as to immunity. Without having held that plaintiffs properly pleaded a claim under the Sherman Act, the *Bedell* court would never have reached the immunity issue. Not only are we bound by the *Bedell* court's holding that the allegations of an output cartel created by the M.S.A. and resulting Qualifying Statutes state a claim for a violation of the Sherman Act, but we reaffirm the legal proposition. We turn therefore to the question whether Defendants are immune under either the *Noerr-Pennington* or the state action — also known as the *Parker* — doctrine.

IV.

ANTITRUST IMMUNITY

Having concluded that Plaintiffs sufficiently state an antitrust claim in that the M.S.A. creates an output cartel that on its face violates the Sherman Act, we consider Defendants' argument that their conduct is immunized from liability. In dismissing Plaintiffs' suit against the Pennsylvania officials, the District Court held that the State officials were entitled to immunity on the basis of the *Noerr-Pennington* doctrine and predicted, on the basis of the

language in *Bedell*, that they would not be entitled to *Parker* immunity. The Plaintiffs argue that the court erred. They posit that a State's implementation and enforcement of a restraint of trade it has adopted or sanctioned is governed by the state action, and not the *Noerr-Pennington*, immunity doctrine. Plaintiffs argue that the state action doctrine fails to shield Defendants from antitrust liability in this case.

Defendants, on the other hand, claim that they are immune from antitrust liability under both the *Noerr-Pennington* and *Parker* doctrines. If we were writing on a clean slate, we might find some logic in Plaintiffs' argument that the conduct of private parties must be evaluated under *Noerr-Pennington* and that of government units under *Parker.* But the slate is not *tabula rasa.*

We consider each immunity doctrine in turn.

A. *Noerr-Pennington* Immunity

In *Bedell*, we concluded that although plaintiffs had properly pleaded an antitrust injury, the *Noerr-Pennington* immunity doctrine nonetheless shielded the Majors from liability, thereby making it appropriate for the district court to dismiss plaintiffs' complaint under Rule 12(b)(6). 263 F.3d at 266-67. The narrow question before us, then, is whether that same immunity extends to the other party to the M.S.A. — the state actors. Here, those actors are Defendants Fisher and Williams. Under the *Noerr-Pennington* doctrine, " '[a] party who petitions the government for redress generally is immune from antitrust liability.' " *Id.* at 250

(citation omitted). That immunity is so potent that it protects petitioning notwithstanding an improper purpose or motive. *Id.*

The doctrine was first established in *E.R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 81 S.Ct. 523, 5 L.Ed.2d 464 (1961), where the Court held that the Sherman Act is not violated simply by attempts by private parties to influence the passage or enforcement of laws favorable to the petitioner despite the anticompetitive effects of those laws. Several years later in *United Mine Workers v. Pennington*, the Court reaffirmed that decision, holding that *"[j]oint* efforts to influence public officials do not violate the antitrust laws even though intended to eliminate competition." 381 U.S. 657, 670, 85 S.Ct. 1585, 14 L.Ed.2d 626 (1965) (emphasis added).

The dual principles underlying the *Noerr-Pennington* doctrine are the constitutional right to petition under the First Amendment and the importance of open communication in representative democracies. *See California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 510, 92 S.Ct. 609, 30 L.Ed.2d 642 (1972). The *Noerr* Court explained:

> In a representative democracy such as this, [the legislative and executive] branches of government act on behalf of the people and, to a very large extent, the whole concept of representation depends upon the ability of the people to make their wishes known to their representatives. To hold that the government retains the power to act in this representative capacity and yet hold,

> at the same time, that the people cannot freely inform the government of their wishes would impute to the Sherman Act a purpose to regulate, not business activity, but political activity, a purpose which would have no basis whatever in the legislative history of that Act[ ].

365 U.S. at 137, 81 S.Ct. 523 (footnote omitted). Thus, *Noerr-Pennington* immunity shields actions that might otherwise violate the Sherman Act because " '[t]he federal antitrust laws do not regulate the conduct of private individuals in seeking anticompetitive action from the government.' " *Bedell*, 263 F.3d at 250-51 (quoting *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365, 379-80, 111 S.Ct. 1344, 113 L.Ed.2d 382 (1991)).

Highlighted as particularly relevant in *Bedell*, and equally relevant to us here, is the recognition that parties are immune from liability arising from the antitrust injuries caused by government action resulting from the petitioning. 263 F.3d at 251. Thus, if the conduct constitutes valid petitioning, the petitioner is immune from antitrust liability whether or not the injuries stem from the actual act of petitioning or from the government action resulting from the petitioning. *Id.*

In *Bedell*, we noted the district court's finding that negotiating the M.S.A. "was akin to petitioning the government" and we agreed that "defendants engaged in petitioning activity with sovereign states . . . are immune under the *Noerr-Pennington* doctrine[ ]." *Id.* at 252 (footnote omitted). We recognized that other courts have also reached this conclusion. *Id.* at 252 n. 31 (citing *Hise v. Philip Morris*

Inc., 46 F.Supp.2d 1201, 1206 (N.D.Okla.1999), *aff'd mem.*, 208 F.3d 226 (10th Cir.2000); *Forces Action Project LLC v. California*, No. C99-0607 MJJ, 2000 WL 20977, at *8 (N.D.Cal. Jan.5, 2000); *PTI, Inc. v. Philip Morris Inc.*, 100 F.Supp.2d 1179, 1193 (C.D.Cal.2000)). Acknowledging plaintiffs' contention that a motivating purpose behind the M.S.A. was to create a cartel with its attendant supra-competitive profits and that the States were motivated by a desire to share in these profits, we nonetheless stated that "the parties' motives are generally irrelevant and carry no legal significance [ ]." *Id.* at 253 (footnote omitted) (citing *Noerr*, 365 U.S. at 138, 81 S.Ct. 523). Instead, we noted that the petitioning invoked the States' traditional powers to regulate the health and welfare of their citizens. *See id.* Accordingly, in *Bedell* we granted *Noerr-Pennington* immunity to the Majors. *Id.* at 254.

As noted previously, Plaintiffs argue that *Noerr-Pennington* immunity is applicable to shield private parties but that it is inapplicable to Defendants because immunity for state actions, if any, must be found in the state action doctrine that applies to a State's implementation and enforcement of an antitrust injury under the Supreme Court's decision of *Parker v. Brown*, 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943). The District Court concluded that by instituting a lawsuit on behalf of Pennsylvania against the tobacco companies, Defendant Fisher was petitioning the courts " 'to recover damages which the Commonwealth and its citizens have sustained as a result of the unlawful and concerted actions of the [tobacco companies].' " *Mariana v. Fisher*, 226 F.Supp.2d 575, 582 (M.D.Pa.2002) (citation omitted). Because the M.S.A. arose from a petition in

proceedings before "other governmental agencies authorized to resolve such issues," Defendants were entitled to *Noerr-Pennington* immunity. *Id.*

In support of that conclusion, we note that Defendant Fisher was among the dozens of Attorneys General across the country who filed suit against the tobacco companies, effectively petitioning the judiciary. In *Trucking Unlimited*, the Supreme Court made explicit that the *Noerr-Pennington* doctrine immunizes petitioning directed at any branch of government, including the executive, legislative, judicial, and administrative agencies. 404 U.S. at 510, 92 S.Ct. 609. In *Bedell*, we held that the settlement that arose from the tobacco lawsuits was petitioning for *Noerr-Pennington* purposes. 263 F.3d at 252.

Plaintiffs argue that *Noerr-Pennington* immunity cannot apply because petitioning immunity cannot apply to a public entity. They provide no persuasive authority. In the one case they cite, *Video Int'l Prod., Inc. v. Warner-Amex Cable Communications, Inc.*, 858 F.2d 1075, 1086 (5th Cir.1988), the plaintiff did not seek to impose liability on the defendant city based on petitioning activity but instead sued the city based on its own zoning enforcement decisions. Thus, the statement in that opinion that "it is impossible for the government to petition itself," *id.*, hardly serves as authority for us. More important, this court in *Herr v. Pequea Twp.*, 274 F.3d 109, 119 n. 9 (3d Cir.2001) (questioned on other grounds by *United Artists Theatre Circuit, Inc. v. Twp. of Warrington*, 316 F.3d 392, 400 (3d Cir.2003)), rejected the proposition in *Video Int'l* that petitioning immunity cannot apply to a public entity.

Appendix A

In *Herr*, a land developer sued a township and three of its supervisors alleging that the township violated his substantive due process rights through a campaign to obstruct his development project. 274 F.3d at 110. The action of the government defendants was participation in proceedings before various courts and the Lancaster County Planning Commission, the Department of Environmental Review, the Environmental Hearing Board, and the Zoning Hearing Board. *Id.* Although *Herr* involved constitutional claims, not an antitrust claim, we stated that the *Noerr-Pennington* doctrine was not limited to the antitrust arena, *id.* at 116, and concluded, over a dissent, that the government officials were entitled to *Noerr-Pennington* immunity as public officials sued in their individual capacities. *Id.* at 119. We acknowledged that we could not find a case addressing whether a municipal corporation is entitled to such immunity, but "predict[ed] . . . that the Supreme Court would hold that it is." *Id.* Although the dissent in *Herr* relied on *Video Int'l*, the majority distinguished it because it did not involve a situation, as in *Herr*, where the plaintiff sought to impose liability on a municipality for petitioning a distinct public entity authorized by state law to resolve land planning issues. *Id.* at 119-20 n. 9.

Plaintiffs argue that unlike *Herr*, this action does not implicate Defendants' petitioning activity and they do not seek to recover damages, but only an injunction against Defendants in their official capacities. But the basis for their claim is that the M.S.A. is a contract or combination that violates the Sherman Act. If the government officials have *Noerr-Pennington* immunity for entering into the MSA, that immunity must extend to complying with and enforcing

its provisions. Like the defendants in *Herr*, Defendants in the current case petitioned governmental entities authorized to resolve the pertinent issues — here the courts and the legislature — in an attempt to advance the goals of Pennsylvania residents. In *Bedell*, we found the Majors' participation in the settlement agreement to be petitioning. 263 F.3d at 252. If the Majors' role in that agreement is petitioning, the role of the state actors, who actually initiated the chain of events leading up to the M.S.A. by initiating the lawsuit and lobbying the legislature, surely must be petitioning.

Although *Noerr-Pennington* immunity typically applies to private, not public, actors, this would not be the first time an appellate court has applied such immunity to public actors. Both the Ninth and Second Circuit Courts of Appeals have extended *Noerr-Pennington* immunity to government actors. *See, e.g., Manistee Town Center v. City of Glendale*, 227 F.3d 1090 (9th Cir.2000); *Miracle Mile Assocs. v. City of Rochester*, 617 F.2d 18 (2d Cir.1980). In *Miracle Mile*, the Second Circuit held that the City of Rochester's petitions to state and federal agencies opposing expansion of a regional shopping center were immunized under *Noerr-Pennington* without a discussion of the public versus private dichotomy. *Id.* at 20-21. However, the Ninth Circuit examined the issue in some detail in *Manistee.*

Plaintiff, Manistee Town Center, purchased and renovated a rundown shopping mall. *Manistee*, 227 F.3d at 1091. When unsuccessful in attracting major retail tenants to the mall, the plaintiff began to explore alternative lease arrangements which were opposed by defendants, the City of Glendale and the Mayor, City Manager, and two City

Council members. *Id.* Defendants sought to prevent the plaintiff's efforts to lease space to certain lessors by encouraging residents and the local press to vocally oppose non-commercial use of the space and by lobbying government officials of the County. *Id.* at 1092. When Manistee Town Center's lease arrangements fell through, it filed a complaint against defendants, in their official capacities, pursuant to 42 U.S.C. §§ 1983 and 1985. *Id.* The district court dismissed plaintiff's § 1983 claim on *Noerr-Pennington* immunity grounds. *Id.*

In affirming the dismissal, the Ninth Circuit acknowledged that the applicability of *Noerr-Pennington* immunity to government actors was a "question of first impression." *Id.* at 1093. The court reasoned that extending such immunity to state actors is consistent with the "representative democracy" rationale enunciated by the Supreme Court in *Noerr*, as "[g]overnment officials are frequently called upon to be ombudsmen for their constituents" whereby "they intercede, lobby, and generate publicity to advance their constituents' goals." *Id.* In holding that *Noerr-Pennington* immunity extended to defendants, the court concluded that this form of petitioning is "nearly as vital" to democracy as petitioning by private citizens. *Id.*

We know of no Supreme Court or federal appellate case holding that *Noerr-Pennington* cannot apply to government actors, and are persuaded by the reasoning employed by the *Manistee* court. Governmental petitioning is as crucial to the modern democracy as is that of private parties. Accordingly, we agree with the District Court that by instituting a lawsuit against the tobacco companies on behalf of the

Commonwealth and lobbying the legislature to pass the TSAA, Defendants engaged in petitioning activities that qualify for *Noerr-Pennington* immunity.

Noerr-Pennington immunity notwithstanding, Defendants argue that they are also eligible for the state action immunity recognized by the Supreme Court 60 years ago in *Parker*. Thus, we consider Defendants' claims as to *Parker* immunity.

B. *Parker* Immunity

Defendants argue with considerable vigor that they also are entitled to state action immunity stemming from the Supreme Court's decision in *Parker*. Plaintiffs counter that because the *Bedell* court found no *Parker* state action immunity for the Majors, we are bound to find no *Parker* immunity for the States.

It is indeed true that this court strictly adheres to its Internal Operating Procedure 9.1 which provides: "It is the tradition of this court that the holding of a panel in a precedential opinion is binding on subsequent panels. Thus, no subsequent panel overrules the holding in a precedential opinion of a previous panel. Court en banc consideration is required to do so." It is also well established that a subsequent panel is not bound by dictum in an earlier opinion. *See, e.g.*, *Burstein v. Ret. Account Plan for Employees of Allegheny Health Educ. and Research Found.*, 334 F.3d 365, 375-76 (3d Cir.2003).

In *Bedell*, once we held that the Majors were immune from antitrust liability under the *Noerr-Pennington* doctrine,

we recognized that "our analysis could end here." Nonetheless, we continued by stating, "[b]ut the District Court found *Parker* immunity, so we will address it as well." 263 F.3d at 254. From this comment, one may deduce we recognized that our subsequent discussion on *Parker* immunity was unnecessary to the holding in *Bedell* and that arguably the state action discussion was dicta. If *Bedell* had concluded that the Majors were immune under the *Parker* doctrine as well as under *Noerr-Pennington*, it would have been an alternate ground for the holding, and therefore not dicta. *See United States ex rel. Caruso v. Zelinsky*, 689 F.2d 435, 440 (3d Cir.1982) ("We note first that an alternate holding has the same force as a single holding; it is binding precedent."). But *Bedell* did not so conclude. 263 F.3d at 266. We therefore turn once again to our opinion in *Bedell* to examine whether its rejection of the applicability of *Parker* immunity for the Majors was dicta or whether it binds us to reject *Parker* immunity for the State Defendants.

In *Bedell*, we embarked on a thorough discussion of the rationale and scope of the *Parker* immunity doctrine. We rescribe only the highlights of that discussion. We characterized as well established that "[a]ntitrust laws do not bar anticompetitive restraints that sovereign states impose 'as an act of government.' " *Id.* at 254 (quoting *Parker*, 317 U.S. at 352, 63 S.Ct. 307). In *Parker*, the Supreme Court held that the California Agriculture Prorate Act, a state statute restricting competition among food producers in California by imposing a market sharing scheme, did not violate the Sherman Act. 317 U.S. at 352, 63 S.Ct. 307. Since then, the Court has consistently held that the federal antitrust laws are subject to supersession by state

regulatory programs. *See, e.g., FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 632-33, 112 S.Ct. 2169, 119 L.Ed.2d 410 (1992).

The *Parker* doctrine is grounded in federalism and respect for state sovereignty. *Bedell*, 263 F.3d at 254. As explained in *Bedell*, the "interest in protecting the acts of the sovereign state, even if anticompetitive, outweighs the importance of a freely competitive marketplace." *Id.* at 254-55. Therefore, clear congressional intent is required before a federal law will be held to invalidate state programs because "an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress." *Parker*, 317 U.S. at 351, 63 S.Ct. 307.

As we acknowledged in *Bedell*, "[w]hen a state clearly acts in its sovereign capacity it avoids the constraints of the Sherman Act and may act anticompetitively to further other policy goals." 263 F.3d at 255. For example, in *Hoover v. Ronwin*, 466 U.S. 558, 104 S.Ct. 1989, 80 L.Ed.2d 590 (1984), the Court considered the claim of an unsuccessful candidate for admission to the Arizona Bar that the members of Arizona's admissions committee violated the Sherman Act by "artificially reducing the numbers of competing attorneys in the State." *Id.* at 565, 104 S.Ct. 1989 (quotation omitted). The Court held that defendants' actions with regard to the bar examination grading formula could not be divorced from the Arizona Supreme Court's exercise of its sovereign power, and thus defendants were immune under *Parker*. *Id.* at 570-73, 104 S.Ct. 1989. It cautioned, however, that conduct that is not directly that of the state legislature and judiciary requires "closer analysis" for purposes of *Parker* immunity

"to ensure that the anticompetitive conduct of the State's representative was contemplated by the State" itself. *Id.* at 568, 104 S.Ct. 1989. In *Bedell*, we stated that when it is uncertain whether we should treat an act as state action because it has been neither approved nor authorized by the State, courts should apply the two-pronged test enunciated by the Supreme Court in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed.2d 233 (1980). 263 F.3d at 259.

To qualify as state action under the *Midcal* test, the challenged restraint must, first, be one that is " 'clearly articulated and affirmatively expressed as state policy,' " and, second, the resulting antitrust violation must be " 'actively supervised' " by the State. *Id.* at 104, 100 S.Ct. 937 (quoting *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 410, 98 S.Ct. 1123, 55 L.Ed.2d 364 (1978)). In *Bedell*, we recognized that it is unnecessary to undertake a *Midcal* analysis if the alleged antitrust injury was the direct result of a clear sovereign state act. 263 F.3d at 256.

Illustrative is our decision in *Massachusetts Sch. of Law at Andover, Inc. v. Am. Bar Ass'n*, 107 F.3d 1026 (3d Cir.1997), a case in which an unaccredited law school that failed to receive accreditation filed an antitrust suit against the American Bar Association ("ABA") alleging a group boycott. We reasoned that any potential antitrust injury arising from the inability of plaintiff's graduates to take bar examinations was the result of state action because it is the State, and not the ABA, that makes the decision as to bar admissions. *Id.* at 1036. We concluded that because the States are sovereign in imposing the bar admission requirements,

the ABA was immune from liability under *Parker*, and the *Midcal* test urged by plaintiff was inapplicable. *Id.* at 1036.

Nonetheless, in *Bedell* we did apply the *Midcal* test. Although we recognized that "one could find direct state action foreclosing the application of *Midcal*" because the M.S.A. "was a negotiated settlement by State Attorneys General, and the state legislatures were responsible for passing the Qualifying Statutes to enforce important components of the agreement," we stated, "it would appear that ... the anticompetitive injury here resulted from the tobacco companies' conduct after implementation of the [MSA], and not from any further positive action by the States." *Bedell*, 263 F.3d at 257-58.

Because this court in *Bedell* examined precisely the same facts and the same documents and concluded that we must apply the *Midcal* test, we believe we are not free to decide to the contrary.

In applying *Midcal's* first prong, we concluded that "it is evident the Multistate Settlement Agreement was backed by clearly articulated state policy. [ ]" *Id.* at 260 (footnote omitted). We believe that conclusion is unassailable and, of course, it applies equally in this case. It was our analysis of the second *Midcal* prong that led us to conclude that the Majors were not entitled to *Parker* immunity. In that connection, we stated that "[t]he essential inquiry of the 'actively supervised' prong is to determine if the 'anticompetitive scheme is the State's own.' " *Id.* (quoting *Ticor Title*, 504 U.S. at 635, 112 S.Ct. 2169). We cited *Patrick v. Burget*, 486 U.S. 94, 101, 108 S.Ct. 1658, 100 L.Ed.2d 83

(1988), for the proposition that active supervision " 'requires that state officials have and exercise power to review particular anticompetitive acts of private parties,' " thereby ensuring that a private party's anticompetitive conduct promotes state policy rather than the party's own interest. *Bedell*, 263 F.3d at 260. We concluded that "[t]he States actively and continually monitor the implementation of portions of the [MSA]," *id.* at 261, but we were "not convinced that the States satisfy *Midcal's* 'active supervision' prong . . . because the States' supervision does not reach the parts of the [MSA] that are the source of the antitrust injury." *Id.* at 262.

It is arguable that in determining that the Majors were not entitled to *Parker* state action immunity, the *Bedell* court placed too little significance on the States' role in the implementation of the MSA. Plaintiffs' principally complain about the rise in cigarette prices following the MSA. *Bedell* recognized that the State has immunity for its role in negotiating, entering into, and enforcing the MSA, but noted that the M.S.A. contains no provision giving the State responsibility to supervise cigarette prices. As the court stated in *Bedell*, "it is clear the [MSA] empowers the tobacco companies to make anticompetitive decisions with no regulatory oversight by the States. Specifically, the defendants are free to fix and raise prices, allegedly without fear of competition." *Id.* at 260.

However, the absence of such a provision is as much state action as are the provisions included in the MSA. The rise in cigarette prices was made possible, at least in part, by the States' enforcement of the M.S.A. provisions

that prevent SPMs and NPMs from expanding their market share, specifically through the market share cap created by the M.S.A. and imposed on SPMs, M.S.A. IX(i)(1), and the TSAA provisions forcing NPMs to either face the same market share cap or pay into a state established escrow account. 35 Pa. Cons.Stat. § 5674. As a matter of logic, there may be some inconsistency in holding the State loses its *Parker* immunity for that which it did in its capacity as a State.

Nonetheless, even though the case before us differs from *Bedell* in that the parties are different, we feel bound by *Bedell* to abstain from reaching a different conclusion on *Parker* immunity. We cannot in conscience characterize the discussion on *Parker* immunity in *Bedell* as dicta. The Supreme Court, in discussing dicta, has stated, "this Court does not decide important questions of law by cursory dicta inserted in *unrelated cases." In re Permian Basin Area Rate Cases*, 390 U.S. 747, 775, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968) (emphasis added). This is neither "cursory dicta" nor an "unrelated case." The discussion makes clear the connection. As we stated in *Bedell*, "[b]ecause private participants in state action enjoy *Parker* immunity only to the extent the States enjoy immunity, the defendants are not shielded by *Parker*.[ ]" *Id.* at 266 (footnote omitted). Perhaps unintentionally, because the issue was not before it, by this sentence *Bedell* seems to have assumed, if not decided, that the States have no *Parker* immunity. Accordingly we, as did *Bedell* for the Majors, hold that the State officials are not entitled to *Parker* immunity.

Critics may with some justification regard our discussion of *Parker* immunity as dictum, and well it may be. In any event, the parties argued *Parker* immunity, *Bedell* discussed it at length and our discussion serves to complete the cycle.

V.

CONSTITUTIONAL CLAIMS

In addition to their antitrust claims, Plaintiffs include claims challenging the constitutionality of the M.S.A. under the Dormant Commerce Clause and Compact Clause. The District Court dismissed Plaintiffs' constitutional claims, concluding that Plaintiffs can prove no set of facts that the M.S.A. violates either clause. *Mariana v. Fisher*, 226 F.Supp. 2d 575 (M.D.Pa.2002). On appeal, we consider whether Plaintiffs properly have stated a cause of action under either the Commerce or Compact Clause.[5]

Although the District Court did not address Plaintiffs' standing, we do so now and conclude that because standing is a jurisdictional requirement, the District Court should have dismissed Plaintiffs' constitutional claims on this ground. Our analysis begins with a review of the rudimentary principles of standing. The standing doctrine is grounded in Article III of the Constitution, which limits the jurisdiction of federal courts to actual "cases" or "controversies." U.S.

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5. As an initial matter, we note that in their brief, Plaintiffs argue that both the M.S.A. and TSAA violate the Commerce Clause. However, we need only address their claims as to the M.S.A. as Plaintiffs' complaint alleges a violation under the Commerce Clause based only on the MSA, and not the TSAA.

Const. art. III, § 2. Thus, it is a jurisdictional requirement that a person challenging a government action be a party to a live case or controversy. *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 358 (4th Cir.2002).

The doctrine of standing is comprised of both " 'constitutional and prudential components.' " *Oxford Assocs. v. Waste Sys. Auth. of E. Montgomery County*, 271 F.3d 140, 145 (3d Cir.2001) (citation omitted). Summarizing its standing jurisprudence over the years, the Supreme Court articulated three "irreducible" elements for constitutional standing. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992). First, the plaintiff must have suffered an "injury in fact," which is an invasion of a legally protected interest that is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical. *Id.* Second, there must be a "causal connection between the injury and the conduct complained of." *Id.* Third and finally, it must be " 'likely' " rather than " 'speculative' " that a favorable decision will redress the injury. *Id.* at 561, 112 S.Ct. 2130 (citation omitted).

The prudential components of standing address the need for judicial restraint, thereby constituting a "supplemental aspect of the basic standing analysis." *Oxford Assocs.*, 271 F.3d at 145. When considering prudential standing, we examine the plaintiff's role because " '[t]he aim of this form of judicial self-governance is to determine whether the plaintiff is a proper party to invoke judicial resolution of the dispute and the exercise of the court's remedial powers.' " *Id.* (citations omitted). Thus, the limits of prudential standing

are used to ensure that those parties who can best pursue a particular claim will gain access to the courts. *Id.*

This court has recently articulated a three-part test for assessing whether a party satisfies prudential standing. First, prudential standing requires that a litigant assert his or her own legal interests rather than those of a third party. *Id.* at 145-46. Second, courts refrain from adjudicating abstract questions of wide public significance amounting to generalized grievances. *Id.* at 146. Third, a plaintiff must demonstrate that his or her interests are arguably within the "zone of interests" that are intended to be protected by the statute, rule, or constitutional provision on which the claim is based. *Id.* For the purposes of determining standing, the court must accept as true all material allegations set forth in plaintiffs' complaint and must construe those facts in favor of the plaintiffs. *Storino v. Borough of Point Pleasant Beach*, 322 F.3d 293, 296 (3d Cir.2003).

Bearing these principles in mind, it seems clear to us that Plaintiffs fail the test for both constitutional and prudential standing. During oral argument, Plaintiffs argued that our decision in *Oxford Assocs.* provided the authority for standing. In *Oxford Assocs.*, a group of building owners brought a suit pursuant to 42 U.S.C. § 1983 against a county's Waste Authority, challenging the Authority's implementation of a waste generation fee ("WGF") structure that forced them to use the local facility to the exclusion of cheaper out of state options. 271 F.3d at 143. Under the challenged fee structure, the building owners had to pay private trash haulers to transport their waste and also had to pay a separate WGF to the Authority to process that waste. *Id.* at 144. They alleged

that the purpose and effect of the WGF was to compel them to subsidize trash processing at the local facility in violation of the Commerce Clause. *Id.* The Authority challenged the building owner's standing on the third prong of the prudential standing test, arguing that their interests were outside the "zone of interests." *Id.* at 145-46. This court, by a divided panel, found that plaintiffs' interests fell within the "zone of interests" because the WGF was imposed directly on plaintiffs, the waste generators, and therefore they had standing to bring their Commerce Clause claim. *Id.* at 148.

Plaintiffs in this case have argued that because *Oxford Assocs.* "permitted [consumers] to bring a suit," they too have standing to make claims under the Commerce Clause. Tr. of Oral Arg., Mar. 12, 2003, at 13. Plaintiffs' reliance on *Oxford Assocs.* is misplaced. The building owners, plaintiffs in *Oxford Assocs.*, were directly subjected to the challenged fee and thus were asserting their own, rather than a third party's, interest. The court was not being asked to address a generalized grievance.

The case before us is easily distinguishable. We need not even reach the "zone of interests" prong of the prudential standing test as Plaintiffs (smokers) fail the test's first prong. Plaintiffs do not allege any personal injury as smokers. Instead, their brief is replete with instances of injury the M.S.A. causes SPMs and NPMs. For example, Plaintiffs argue that:

> The M.S.A. and TSAA do not expressly favor Pennsylvania manufacturers over out-of-state manufacturers; nor do they treat more favorably

> cigarettes manufactured or processed in Pennsylvania in comparison to cigarettes manufactured or processed elsewhere. This state regulation, however, has the purpose and effect of favoring a finite set of businesses, *i.e.*, the Majors, by protecting their market share through the output limitations and payment obligations imposed on SPMs and NPMs alleged in the complaint.

Br. of Plaintiffs at 45-46.

Plaintiffs do not complain that the MSA's payment structure injures them as smokers. Because Plaintiffs are not asserting their own legal interests but instead those of third parties — here the SPMs and NPMs — they are not analogous to the plaintiffs in *Oxford Assocs.*, who alleged that they personally were injured by the fee structure at issue in that case. Instead, Plaintiffs' Commerce Clause arguments devolve into nothing more than generalized grievances against the MSA. Accordingly, the doctrine of prudential standing precludes us from hearing such claims.

Moreover, Plaintiffs cannot get past the first of the constitutional standing requirements — injury in fact. The Court has made clear that to have constitutional standing, the " 'injury in fact' test requires more than an injury to a cognizable interest. It requires that the party seeking review be himself among the injured." *Lujan*, 504 U.S. at 563, 112 S.Ct. 2130 (citation omitted). This injury must be concrete and particularized rather than conjectural or hypothetical. *Id.* at 560, 112 S.Ct. 2130. Unlike their allegations directed to

the antitrust laws, Plaintiffs make what can only be described as conjectural allegations as to their constitutional claims. The relevant Commerce Clause allegation in the complaint is merely: "The M.S.A. unduly encroaches upon the enumerated federal power over interstate commerce set forth in the United States Constitution, Article I, Section 8, Clause 3." App. at 52.

Plaintiffs' allegation as to the Compact Clause is no more descriptive:

> The M.S.A. is a multistate agreement that violates the Compacts Clause of the United States Constitution, Article I, Section 10, Clause 3, in that it is a combination tending to the increase of power in the states which has or may encroach upon the just supremacy of the United States to regulate interstate trade in the domestic cigarette market.

App at. 53.

Although Plaintiffs' brief is filled with generalized grievances as to how the M.S.A. § and TSAA force SPMs and NPMs to make payments that violate the antitrust laws, it fails to make particularized and concrete allegations as to how Plaintiffs, as smokers, suffer injury in fact, and therefore Plaintiffs lack constitutional standing.

VI.

CONCLUSION

For the reasons set forth, we will affirm the District Court's order dismissing Plaintiffs' complaint. As to Plaintiffs' antitrust claims, we have concluded that Defendants are entitled to immunity under *Noerr-Pennington*. We affirm the District Court's dismissal of Plaintiffs' constitutional claims, but we do so on jurisdictional grounds rather than on the merits.

APPENDIX B — MEMORANDUM OF THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF PENNSYLVANIA DATED JULY 17, 2002

UNITED STATES DISTRICT COURT
M.D. PENNSYLVANIA

No. CIV. 1:CV-01-2070

June 17, 2002

Robert MARIANA, Michael J. McFadden, Karen M. Moran, and Edward M. Nankervis,

Plaintiffs

v.

D. Michael FISHER, in his official capacity as Attorney General of the Commonwealth of Pennsylvania, and Larry P. Williams, in his official capacity as Secretary of Revenue of the Commonwealth of Pennsylvania,

Defendants

* * *

MEMORANDUM

RAMBO, District Judge.

Before the court is Defendants' motion to dismiss Plaintiffs' complaint pursuant to Federal Rule of Civil

Procedure 12(b)(6), or, in the alternative, pursuant to Rule 12(b)(7). The parties have briefed the issues, and the motion is ripe for disposition.

I. *Background*

Plaintiffs' complaint, filed on January 10, 2002, alleges the following:

A. *Introduction and Parties*

Plaintiffs challenge certain provisions of the Master Settlement Agreement (hereinafter the "MSA") that the four largest United States tobacco companies (the "Majors") entered into with forty six states on November 23, 1998. Plaintiffs allege that the M.S.A. § violates Section 1 of the Sherman Act, 15 U.S.C. § 1, as well as the Commerce and Compact Clauses of the United States Constitution.

Plaintiffs are all Pennsylvania residents and cigarette consumers. Defendant Michael Fisher is the Attorney General of Pennsylvania, and Defendant Larry Williams is the Secretary of the Pennsylvania Department of Revenue. Defendant Fisher was one of eight state Attorneys General that negotiated the MSA, and his office receives the payments from the settlement. Defendant Williams collects the revenues from the settlement. The Majors—Philip Morris, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corp., and Lorillard Tobacco Company—are not named as Defendants in the instant suit because the Third Circuit has held that the *Noerr-Pennington* immunity doctrine

shields them from liability from suit. (Compl. at ¶ 10 (citing *A.D. Bedell Wholesale Co. v. Philip Morris, Inc.*, 263 F.3d 239 (3d Cir.2001).)

B. *The Relevant Market*

The relevant market for Plaintiffs' antitrust action is the sale of tobacco products by cigarette manufacturers and importers of cigarettes in the United States. This market is highly concentrated. "For decades, the market consisted of six major manufacturers" which included the Majors, American Tobacco Company, and Vector Group. (Compl. at ¶ 12.) When the M.S.A. § was negotiated in 1998, the Majors collectively accounted for more than 98% of sales in the domestic market. In the first six months of 2001, the Majors had increased prices for cigarettes by 60%, and had a combined market share of 93.6%. The rest of the market is comprised of small manufacturers and importers.

Domestic cigarette consumption has not declined since the M.S.A. § was entered into. In 1999, there was a 10% decline in the shipments of cigarettes, but in 2000, shipments increased. At the manufacturers' level, industry revenues have increased from $21 billion in 1997 to $45 billion in 2000.

C. *The MSA*

The M.S.A. § was negotiated as a result of a series of lawsuits brought or threatened by the states against the Majors and other companies and organizations in the tobacco industry. The states sought to recover Medicaid funds

expended in treating tobacco related diseases. Pennsylvania filed suit against the Majors in April 1997. *Pennsylvania v. Philip Morris, Inc.*, No. 9704-2443 (Ct. Com. Pleas, Phila. County, April 1997). The suit was settled as part of the MSA.

Pursuant to the MSA, the Majors agreed to pay the settling states initial and annual payments totaling $206 billion over the first twenty-five years and $9 billion annually after that. The M.S.A. § also includes marketing restrictions, regulations of lobbying, and "restrictions on association." (Compl. at ¶ 18.) These restrictions have further entrenched the Majors' market share.

The Majors required that the M.S.A. § include structures so that the Majors could fund transfers of billions of dollars to the states by having wholesalers and consumers pay artificially high prices for cigarettes. The prices charged by the Majors since the M.S.A. § was entered into have generated revenue far in excess of what is needed to fund the M.S.A. § and have enabled the Majors to spend record amounts on advertising.

D. *The Output Cartel Created by the MSA*

Certain provisions of the M.S.A. § restrict the output of the Majors' competitors and prevent the competitors from gaining market share. The M.S.A. § was designed to destroy the free market for cigarettes so that consumers would not be able to choose lower priced products of companies that did not raise prices to fund the MSA. The state Attorneys General crafted the M.S.A. § to save the Majors and "ensure a perpetual shared and unregulated monopoly for [the Majors]." (Compl. at ¶ 20.)

Appendix B

The M.S.A. § prevents Subsequent Participating Manufacturers ("SPMs") and Non-Participating Manufacturers ("NPMs") of cigarettes from expanding their market share and prevents new competitors from entering the market. The M.S.A. § coerces smaller companies to join the MSA, and furthers a tradition of anticompetitive conduct. The M.S.A. § displaces competition in the cigarette industry in the following ways: (1) it contains discount sales by small competitors; (2) it prevents the entry of new competitors at the discount end of the market; (3) it prevents significant price competition among the Majors; and (4) it permits significant price increases through tacit agreements to raise prices.

The M.S.A. § has two provisions that stifle price competition. First, it requires each state to enact a "Qualifying Statute" that "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating Manufacturers within such Settling State. . . ." (*Id.* at ¶ 24 (citing M.S.A. §§ IX(d)(2)(E).). The Qualifying Statutes require NPMs to pay "massive amounts" into an Escrow Fund for the payment of potential damages in future health care liability suits. A $50 million "enforcement" fund was established to finance enforcement of the Qualifying Statutes and the MSA.

Pennsylvania's Qualifying Statute is called the "Tobacco Settlement Agreement Act," ("TSAA"), 35 Pa. Stat. Ann. §§ 5672-5674. The TSAA requires that NPMs either become an SPM of the M.S.A. § or make payments into escrow. In 2000, payments were $2.09 per carton of cigarettes, increasing to $3.77 per carton in 2007. If the

NPMs' payments under the Qualifying Statute are higher than they would be as an SPM of the MSA, the excess is returned to the NPM.

The option to remain an NPM is prohibitively expensive, and "the only option that permitted an NPM to remain in business without violating the Qualifying Statutes was to join the M.S.A. § and become an SPM." (Compl. at ¶ 26.) Thus, small manufacturers became SPMs, but are restricted from gaining market share by the "Renegade Clause" in the MSA. This provision states: "A [n] [SPM] shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of (1) its 1998 Market Share or (2) 125 percent of its 1997 Market Share." (Compl. at ¶ 27 (citing M.S.A. § § IX(i).) This provision creates disincentives for SPMs to increase production and market share.

The M.S.A. § also imposes barriers against new entrants in the market. Specifically, it provides that the 1997 market share for new entrants will be 0% for determining the market share cap. (*Id.* at ¶ 29 (citing M.S.A. §§ IX(i)(4).) New entrants must contribute settlement payments or pay penalties under the Qualifying Statutes.

The M.S.A. § also establishes penalties for the encroachment of market shares among the Majors. (*Id.* at ¶ 33 (citing M.S.A. §§ IX(d)(3)):

> This section [of the MSA] contains a complicated formula under which a manufacturer who gains market share relative to its 1997 market share has

> to pay an increased amount of the settlement in any given year and the manufacturer whose market share in that given year was less than its market share in 1997 will have to pay correspondingly less.

(*Id.*) Advertising and promotional restrictions also make it more difficult for the Majors to obtain incremental market shares.

E. *The Majors Take Advantage of the Output Cartel*

Within two days of executing the MSA, the Majors increased cigarette prices by $.45 per pack. Prices have consistently gone up, and the wholesale price of a carton of cigarettes has risen from approximately $19 per carton to $30 per carton in two and a half years. This has created "an acute but unfulfilled demand for affordable cigarettes." (*Id.* at ¶ 37.) The price increases have not been monitored or regulated by any state.

F. *Plaintiffs' Claims*

Plaintiffs assert the following claims: (1) the acts and agreements discussed above constitute a contract, combination or conspiracy in restraint of trade in violation of the Sherman Act, 15 U.S.C. § 1 (Count I); (2) the M.S.A. § violates the Commerce Clause, U.S. Const., art. I, § 8, cl. 3 (Count II); and (3) the M.S.A. § violates the Compact Clause, U.S. Const., art. I, § 10, cl. 3 (Count III). Plaintiffs seek declaratory judgment to enjoin Defendants from the continued implementation, enforcement and performance of

the M.S.A. § on behalf of Pennsylvania. Plaintiffs also seek attorneys fees, costs, and expenses.

II. *Legal Standard: Motion to Dismiss*

In deciding a motion to dismiss pursuant to Federal Rule 12(b)(6), the court is required to accept as true all of the factual allegations in the complaint and all reasonable inferences that can be drawn from the face of the complaint. *Nami v. Fauver,* 82 F.3d 63, 65 (3d Cir.1996). "The complaint will be deemed to have alleged sufficient facts if it adequately put[s] the defendant[s] on notice of the essential elements of the plaintiff's cause of action." *Nami,* 82 F.3d at 65. The court will not dismiss a complaint for failure to state a claim "unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of her claims that would entitle her to relief." *Conley v. Gibson,* 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957).

"In determining whether a claim should be dismissed under [Federal] Rule 12(b)(6), a court looks only to the facts alleged in the complaint and its attachments without reference to other parts of the record." *Jordan v. Fox, Rothschild, O'Brien & Frankel,* 20 F.3d 1250, 1261 (3d Cir.1994). The court may consider an "undisputedly authentic document that a defendant attaches as an exhibit to a motion to dismiss if the plaintiff's claims are based on the [attached] document." *Pension Ben. Guar. Corp. v. White Consol. Ind,* 998 F.2d 1192, 1196 (3d Cir.1993). Finally, in the Third Circuit, a court must grant leave to amend before dismissing a complaint that is merely deficient. *See, e.g., Weston v. Pennsylvania,* 251 F.3d 420, 428 (3d Cir.2001); *Shane v. Fauver,* 213 F.3d 113, 116-17 (3d Cir.2000).

Appendix B

III. *Discussion*

A. *Count I: Antitrust Claims*

Defendants move to dismiss Plaintiffs' antitrust claims for the following reasons: (1) Plaintiffs' claims are barred under the *Noerr-Pennington* doctrine; (2) the M.S.A. § and TSAA are state action which is exempt from antitrust laws; (3) the M.S.A. § and TSAA do not "irreconcilably conflict" with and are not preempted by the Sherman Act; and (4) the provisions of the M.S.A. § and the TSAA do not require or authorize any unlawful agreement to restrict output. As discussed below, the court finds that Defendants are entitled to *Noerr-Pennington* immunity. While the court will briefly address the issue of *Parker* immunity in addition to *Noerr-Pennington* immunity, it is not necessary to address Defendants' other bases for dismissal of the Sherman Act claims.

1. *Noerr-Pennington Doctrine*

Defendants first assert that Plaintiffs' antitrust claims are barred by the *Noerr-Pennington* doctrine. The Third Circuit recently described the doctrine as follows: "[r]ooted in the First Amendment and fears about the threat of chilling political speech, the doctrine was first recognized in two Supreme Court cases holding federal antitrust laws inapplicable to private parties who attempted to influence government action-even where the petitioning had anticompetitive effects." *A.D. Bedell Wholesale Co. v. Philip Morris, Inc.*, 263 F.3d 239, 250 (3d Cir.2001) (citing *United Mine Workers v. Pennington*, 381 U.S. 657, 85 S.Ct. 1585,

14 L.Ed.2d 626 (1965); *E. R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 81 S.Ct. 523, 5 L.Ed.2d 464 (1961)). Pursuant to this doctrine, immunity extends to attempts to petition all departments of the government. *Id.* Finally, "if [] conduct constitutes valid petitioning, the petitioner is immune from antitrust liability whether or not the injuries are caused by the act of petitioning or are caused by government action which results from the petitioning." *Id.* at 251.

In *Bedell,* a cigarette wholesaler brought a class action suit against the Majors. The plaintiff sought damages and injunctive relief for alleged antitrust injuries flowing out of certain provisions of the MSA. *Id.* at 241. The district court dismissed the Sherman Act claims, finding the Majors immune from suit pursuant to *Noerr-Pennington. Id.* at 250.

On appeal, the Third Circuit refused to differentiate a settlement from other acts associated with litigation to which courts have extended *Noerr-Pennington* immunity. *Id.* at 252-53 (citing *California Motor Transp. Co. v. Trucking Unlimited,* 404 U.S. 508, 510-11, 92 S.Ct. 609, 30 L.Ed.2d 642 (1972) (extending *Noerr* immunity to actions before administrative agencies and the courts); *McGuire Oil Co. v. Mapco, Inc.*, 958 F.2d 1552, 1560 (11th Cir.1992) (extending *Noerr* immunity to include efforts to influence governmental action incidental to litigation); *Coastal States Mktg., Inc. v. Hunt,* 694 F.2d 1358, 1367-68 (5th Cir.1983) (same)). Thus, the appellate court affirmed the district court with respect to the *Noerr-Pennington* issue. *Id.* at 254 ("Freedom from the threat of antitrust liability should apply to settlement agreements as it does to other more traditional petitioning

activities. We hold the defendants are immune under the *Noerr-Pennington* doctrine.")

Defendants in the instant action, *i.e.*, Attorney General Fisher and Secretary Williams, assert that *Bedell* mandates dismissal of the case at bar. Defendants aver that the Third Circuit in *Bedell* held "that antitrust claims predicated on the M.S.A. § and the TSAA are barred by *Noerr* immunity." (Defs. Br. Supp. Mot. Dism., "Defs. Supp. Br." at 19.) Defendants further contend that Plaintiffs are trying to circumvent the holding of *Bedell* with respect to *Noerr-Pennington* immunity by naming Commonwealth officials as Defendants rather than the private tobacco manufacturers. (*Id.* at 20.)

In response, Plaintiffs argue, "[w]hen a private party asks a State or state official to adopt or agree to a restraint of trade, neither the restraint adopted nor enforcement or implementation by the State or state official becomes immune simply because someone asked for the restraint." (Pls. Br. Opp. Mot. Dism., "Pls. Opp. Br." at 13.) Plaintiffs cite *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110, 100 S.Ct. 937, 63 L.Ed.2d 233 (1980) in support of their position. While the *Midcal* case is pertinent to the issue of antitrust immunity under *Parker v. Brown*, 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943), discussed *infra*, it is not relevant to the issue of whether Defendants are entitled to *Noerr-Pennington* immunity.[1]

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1. *Midcal* involved a lawsuit by a wine distributer challenging California's resale price maintenance and price posting statutes for

(Cont'd)

Essentially, Plaintiffs assert that *Parker v. Brown,* not the *Noerr-Pennington* doctrine, is the proper basis on which to analyze government conduct in an antitrust suit. Plaintiffs cite a litany of cases that support this position. *See, e.g., Bedell,* 263 F.3d at 250 ("*Parker* protects the States' act of governing, and Noerr the citizens' participation in government."); *Nursing Registry, Inc. v. Eastern North Carolina Reg'l. Emerg. Med. Servs. Consortium, Inc.,* 959 F.Supp. 298 (E.D.N.C.1997); *Bright v. Ogden City,* 635 F.Supp. 31, 33 (D.Utah 1985) (stating that state action doctrine is separate from *Noerr-Pennington* doctrine, and that states may not be immune from liability even if private actors are immune); *see also Video Int'l Prod., Inc. v. Warner-Amex Cable Communications, Inc.,* 858 F.2d 1075, 1086 ("*Noerr-Pennington* protection does not apply to the government, of course, since it is impossible for the government to petition itself within the meaning of the first amendment."); *In re Airport Car Rental Antitrust Litigation,* 693 F.2d 84, 87 (9th Cir.1982) (stating that liability of state and private entities are governed by different doctrines and one may be immune even if the other is not).

Defendants take the position that, in appropriate circumstances, *Noerr-Pennington* immunity extends to

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(Cont'd)

wine wholesalers. 445 U.S. at 99, 100 S.Ct. 937. The page cited by Plaintiffs contains a discussion of the Twenty-first Amendment of the United States Constitution, a provision completely irrelevant to the instant action. *Id.* at 110, 100 S.Ct. 937. Although the *Midcal* opinion also discusses *Parker* immunity, that discussion is not relevant to the court's determination of *Noerr-Pennington* immunity. The nuances of each are discussed more fully above.

government agencies, and not just private citizens. Defendants rely heavily on the Third Circuit's decision in *Herr v. Pequea Township,* 274 F.3d 109 (3d Cir.2001). In *Herr,* a land developer sued a township and three of its supervisors, alleging that the township violated his substantive due process rights through a campaign to obstruct the plaintiff's development project. *Id.* at 110. *Herr* did not involve an antitrust claim. However, the Third Circuit discussed the *Noerr-Pennington* doctrine, and noted that "the restrictions on liability [under *Noerr-Pennington*] are applicable to liability under state tort laws . . . and to liability under the Civil Rights Act." *Id.* at 117 (citing *Video Int'l Prod.*, 858 F.2d at 1084). The government defendants in *Herr* were actual participants in proceedings before the Lancaster County Planning Commission, the Department of Environmental Review, the Environmental Hearing Board, the Zoning Hearing Board, and certain courts. *Id.* at 110. The Third Circuit held that the township's and officials' conduct was protected because the defendants "participated in proceedings *before other governmental agencies* authorized to resolve issues like those here presented." *Id.* at 112 (emphasis added).

Defendants also cite *Manistee Town Center v. City of Glendale,* 227 F.3d 1090, 1092 (9th Cir.2000). In *Manistee,* the City of Glendale lobbied the county to stop the county from leasing space in a shopping center owned by the plaintiff. *Id.* at 1091. The Ninth Circuit Court of Appeals affirmed the dismissal of the claims based on the *Noerr-Pennington* doctrine. *Id.* The court explained:

> Government officials are frequently called upon to be ombudsmen for their constituents. In this

> capacity, they intercede, lobby, and generate publicity to advance their constituents' goals, both expressed and perceived. This kind of petitioning may be nearly as vital to the functioning of a modern representative democracy as petitioning that originates with private citizens.

Id. While the Ninth Circuit noted that precedent regarding the applicability of *Noerr-Pennington* to petitioning governmental bodies is "sparse," it also stated that existing cases support its conclusion. *Id.* at 1094 (citing *Miracle Mile Assocs. v. City of Rochester,* 617 F.2d 18, 20 (2d Cir.1980); *Fischer Sand & Aggregate Co. v. City of Lakeville,* 874 F.Supp. 957, 959-60 (D.Minn.1994); *County of Suffolk v. Long Island Lighting Co.,* 710 F.Supp. 1387, 1390 (E.D.N.Y. 1989)).

Defendants in the instant action are entitled to *Noerr-Pennington* immunity. Defendant Fisher instituted a lawsuit on behalf of the Commonwealth of Pennsylvania. In doing so, he petitioned the courts "to recover damages which the Commonwealth and its citizens have sustained as a result of the unlawful and concerted actions of the defendants." *Pennsylvania v. Philip Morris, Inc.,* No. 9704-2443 (Ct.Cm. Pleas, Phila.1997) (Compl. at ¶ 15.) The *Noerr-Pennington* doctrine immunizes petitions that are directed at any branch of the government, including the judiciary. *California Motor Trans. Co. v. Trucking Unlimited,* 404 U.S. 508, 510, 92 S.Ct. 609, 30 L.Ed.2d 642 (1972). In petitioning the judicial branch for redress, Defendant Fisher was petitioning the courts to advance his constituents' goals. Furthermore, the Third Circuit has defined the states conduct here as "petitioning."

Bedell, 263 F.3d at 253 ("[T]he petitioning here invoked the state's traditional powers to regulate the health and welfare of its citizens.") Because the M.S.A. § arose out of a petition in proceedings before other governmental agencies authorized to resolve such issues, the court finds that Defendants are entitled to *Noerr-Pennington* immunity. The court also holds that Plaintiffs' complaint is not merely deficient and that granting leave to amend would not enable Plaintiffs to state a viable claim under the Sherman Act. Therefore, Count I will be dismissed.

2. *State Action Doctrine*

Defendants also proffer that even if they are not entitled to *Noerr-Pennington* immunity, their conduct is protected from antitrust liability as state action under *Parker v. Brown,* 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943). As the court has already determined that Defendants are entitled to *Noerr-Pennington* immunity, it need not provide a lengthy discussion of *Parker* immunity. However, the court will briefly address this issue.

In *Parker,* the Supreme Court held that "[a]ntitrust laws do not bar anticompetitive retraints that sovereign states impose 'as an act of government.'" *Bedell,* 263 F.3d at 254 (citing *Parker,* 317 U.S. at 352, 63 S.Ct. 307; *Massachusetts School of Law at Andover, Inc. v. Am. Bar Ass'n,* 107 F.3d 1026, 1035 (3d Cir.1997)). In order to receive *Parker* immunity, the anticompetitive restraint must be the product of sovereign state action. *Id.* In *Bedell,* the Third Circuit discussed the application of *Parker* immunity to the MSA. *Id.* at 254-66.

Appendix B

The Third Circuit applied the test promulgated in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 104, 100 S.Ct. 937, 63 L.Ed.2d 233 (1980), in order to determine whether the M.S.A. § should be considered state action.[2] The *Midcal* test has two prongs. First, to qualify as state action, the restraint must be "clearly articulated and affirmatively expressed as state policy." *Midcal,* 445 U.S. at 104, 100 S.Ct. 937 (citation omitted). Second, the challenged restraint must be "actively supervised" by the state. *Bedell,* 263 F.3d at 260. "The essential inquiry of the 'actively supervised' prong is to determine if the 'anticompetitive scheme is the State's own.'" *Id.* (citing *FTC v. Ticor Title Ins. Co.,* 504 U.S. 621, 635, 112 S.Ct. 2169, 119 L.Ed.2d 410 (1992)).

The Third Circuit made two findings with respect to the MSA. First, the court held that the M.S.A. § was the product of a clearly articulated state policy. *Id.* However, the court also held that there is not adequate state supervision of the M.S.A. § to satisfy the second prong of *Midcal. Id.* at 265. Accordingly, the court found that the "participants" to the M.S.A. § are not entitled to *Parker* immunity. *Id.*

Defendants in the case at bar would have the court follow Bedell with respect to *Noerr-Pennington* immunity, while asking the court to disregard the opinion with respect to

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2. *Midcal* is applicable "[w]hen it is uncertain whether an act should be treated as state action for the purposes of *Parker* immunity . . . to 'determine whether anticompetitive conduct engaged in by private parties should be deemed state action.'" *Bedell,* 263 F.3d at 255 (citing *Patrick v. Burget,* 486 U.S. 94, 100, 108 S.Ct. 1658, 100 L.Ed.2d 83 (1988)).

Parker immunity. Defendants label the discussion of *Parker* immunity in Bedell as dicta. Even if the court were to view the twelve pages of opinion in Bedell regarding *Parker* immunity as dicta, it is clearly indicative of how the Third Circuit would rule if presented with the case at bar. Thus, the court finds that in the action before it, Defendants are not entitled to Parker immunity. However, as the court has already determined that Defendants are entitled to *Noerr-Pennington* immunity, the Sherman Act claim will still be dismissed.

B. *Count II: Commerce Clause*

In Count II of the their complaint, Plaintiffs allege that "the M.S.A. § unduly encroaches upon the enumerated federal power over interstate commerce set forth in the United States Constitution, Article I, Section 8, Clause 3." (Compl. at ¶ 51.) Where state laws impermissibly discriminate against interstate commerce, this implicates what is sometimes referred to as the "dormant" or "negative" aspect of the Commerce Clause. *See West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 192, 114 S.Ct. 2205, 129 L.Ed.2d 157 (1994).

The Supreme Court applies a two-tiered analysis to claims that a state regulation violates the Commerce Clause. First, a state regulation is automatically struck down if it "directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests." *Brown-Forman Distillers v. New York Liquor Auth.,* 476 U.S. 573, 579, 106 S.Ct. 2080, 90 L.Ed.2d 552 (1986) (citations omitted). However, where a state regulates commerce evenhandedly

and only affects interstate commerce indirectly, then courts must apply the balancing test derived from *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970). The *Pike* balancing test asks "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits." *Brown-Forman,* 476 U.S. at 579, 106 S.Ct. 2080 (citing *Pike,* 397 U.S. at 142, 90 S.Ct. 844).

There is no bright line rule for determining whether a state regulation is *per se* invalid or requires the application of the *Pike* balancing test. Instead, courts must look at "the overall effect of the statute on both local and interstate activity." *Id.* (citing *Raymond Motor Transp., Inc. v. Rice,* 434 U.S. 429, 440-41, 98 S.Ct. 787, 54 L.Ed.2d 664 (1978)). Notably, the Commerce Clause does not prevent states from passing legislation that benefits their citizens' health and safety. *See Huron Portland Cement Co. v. Detroit,* 362 U.S. 440, 443-44, 80 S.Ct. 813, 4 L.Ed.2d 852 (1960) ("[T]he Constitution . . . never intended to cut the States off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country.")

In moving to dismiss Plaintiffs' Commerce Clause claim, Defendants argue that the M.S.A. § does not discriminate against out of state goods; that it was not executed with protectionist goals; that it does not target out of state commerce; and that it evenhandedly imposes obligations on U.S. cigarette manufacturers. Defendants also cite several cases, and assert that no courts have found that the M.S.A. § or qualifying statutes violate the Commerce Clause.

(Defs. Supp. Br. at 35) (citing *Star Scientific, Inc. v. Beales,* 278 F.3d 339 (4th Cir.2002); *Forces Action Project LLC v. California,* No. C-99-0607 MJJ (N.D.Cal. Jan.15, 2000); *Star Scientific, Inc. v. Carter,* No. IP O1-0838-C T/G (S.D.Ind. Aug. 20, 2001); *Premium Tobacco Stores, Inc. v. Fisher,* 51 F.Supp.2d 1099, 1105 (D.Colo.1999).)

In response, Plaintiffs assert that the M.S.A. § and TSAA control conduct outside of Pennsylvania and interfere with interstate commerce in the following ways: (1) the M.S.A. § calculates payments based on national market shares rather than local market shares, and, by passing on costs to consumers in every state, "effectively collects money from consumers in other states" (Pls. Opp. Br. at 31;) (2) the M.S.A. § limits national sales and market shares by imposing larger payments on SPMs who increase their national market shares, effectively giving up their cost advantage in states that are not M.S.A. § parties to avoid incurring the M.S.A. § penalties associated with gaining market shares; (3) the TSAA affects sales by NPMs occurring entirely outside of Pennsylvania, thereby raising prices in all fifty states; and (4) the M.S.A. § coerces states to enact qualifying statutes that result in costs to the Majors' competitors which are passed on to consumers. As legal support for their Commerce Clause claim, Plaintiffs rely heavily on two Supreme Court cases. *See Healy v. Beer Inst.,* 491 U.S. 324, 336, 109 S.Ct. 2491, 105 L.Ed.2d 275 (1989); *Brown-Forman,* 476 U.S. at 582-83, 106 S.Ct. 2080. Plaintiffs also assert that the cases cited by Defendants regarding Commerce Clause challenges to the M.S.A. § are inapposite.

Appendix B

The court will begin with a review of the Supreme Court cases relied upon by Plaintiffs. Both *Brown-Forman* and *Healy* tested the validity of state liquor price-affirmation statutes. *Healy,* 491 U.S. at 326, 109 S.Ct. 2491; *Brown-Forman,* 476 U.S. at 575-76, 106 S.Ct. 2080. In *Brown-Forman,* a distiller who sold alcohol in New York State and other states challenged a statute that required distillers and agents selling alcohol in New York State to file a monthly price schedule with the State Liquor Authority. 476 U.S. at 575, 106 S.Ct. 2080. The price schedule had to include an affirmation that "the bottle and case price of liquor to wholesalers set forth in such schedule is no higher than the lowest price at which such item of liquor will be sold" in any other state during the month covered by the schedule. *Id.* at 576, 106 S.Ct. 2080. In *Healy,* the challenged statute required that "out-of-state shippers [of alcohol into Connecticut] to affirm that their prices are no higher than the prices being charged in the border States as of the moment of affirmation." 491 U.S. at 335, 109 S.Ct. 2491. The Supreme Court struck down both provisions as violative of the Commerce Clause. *Healy,* 491 U.S. at 343, 109 S.Ct. 2491; *Brown-Forman,* 476 U.S. at 584, 106 S.Ct. 2080.

In *Healy,* the Supreme Court discussed general principles gleaned from Commerce Clause cases:

> Taken together, our cases concerning the extraterritorial effects of state economic regulation stand at a minimum for the following propositions: First, the Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the

> State's borders, whether or not the commerce has effects within the State. . . . [S]pecifically, a State may not adopt legislation that has the practical effect of establishing a scale of prices for use in other states. . . . Second, a statute that directly controls commerce occurring wholly outside the boundaries of a State . . . is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State. Third, the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interfere with the legitimate regulatory regimes of other States. . . . Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another state. And, specifically, the Commerce Clause dictates that no State may force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another.

Id. at 336-37, 109 S.Ct. 2491 (internal citations omitted).

Applying these principles, the Court concluded that Connecticut's price affirming statute effectively controlled commercial activity occurring wholly outside Connecticut. *Id.* at 337, 109 S.Ct. 2491. Furthermore, the court noted that the statute, in conjunction with the price affirming statutes

of other states, created a competing and interlocking economic regulation that is invalid under the Commerce Clause. *Id.*

Plaintiffs argue at length that the M.S.A. § and TSAA result in the forfeiture of a competitive advantage in states that are not parties to the MSA. The Supreme Court did state in *Brown-Forman* and *Healy* that "States may not deprive businesses and consumers in other States of 'whatever competitive advantages they may possess' based on the conditions of the local market." *Id.* at 339, 114 S.Ct. 2205 (citing *Brown-Forman,* 476 U.S. at 580, 106 S.Ct. 2080). However, while both *Healy* and *Brown-Forman* contain general standards with respect to Commerce Clause violations, the cases are very fact specific. In *Healy,* the Court noted that the case was its "fourth expedition into the area of price-affirmation statutes." 491 U.S. at 331, 109 S.Ct. 2491. The Court further stated that the Connecticut law was invalid on its face because it singled out brewers and shippers of beer that engaged in interstate commerce. *Id.* at 340-41, 109 S.Ct. 2491. Finally, when concluding its opinion in *Healy,* the Supreme Court sought to remove "any lingering uncertainty about the constitutional validity of affirmation statutes." *Id.* at 343, 109 S.Ct. 2491. Thus, the Court indicated that its inquiry, if not limited, was largely focused on price-affirmation statutes.

Turning to the case at bar, neither the facts, nor the general principles of *Brown-Forman* or *Healy,* support Plaintiffs' allegations that the M.S.A. § violates the Commerce Clause. First, unlike the price affirmation laws before the Supreme Court, the M.S.A. § is not a statute

promulgated by the state legislature. Rather, it is a settlement agreement that disposed of pending litigation.[3] Thus, while Plaintiffs attempt to draw analogies to *Brown-Forman* and *Healy,* the M.S.A. § does not contain "pricing decisions [that] are imported by statutes into the [local] market regardless of local competitive conditions." *Healy,* 491 U.S. at 339, 109 S.Ct. 2491.

Even if the court here applies the general principles of *Healy,* Plaintiffs have failed to allege a cause of action under the Commerce Clause. There is no allegation that the M.S.A. § adopts a scale of prices that is applicable in other states, and the M.S.A. § does not contain mandates on pricing akin to those in *Healy* or *Brown-Forman.* Furthermore, there is no set of facts that Plaintiffs could prove that would show that Defendants are controlling conduct beyond the state, especially not in a way that has the effect of favoring in-state economic interests over out of state economic interests. Finally, there are no allegations regarding inconsistent regulations that arise from the projection of a Pennsylvania regulatory scheme onto another state. Pennsylvania is not forcing extraterritorial cigarette manufacturers to seek regulatory approval before they conduct business in Pennsylvania or any other state.

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3. While Plaintiffs put forth an argument about how the TSAA violates the Commerce Clause in the briefing, Plaintiffs' complaint only contains a Commerce Clause claim based on the MSA. (Compl. at ¶ 51.) Thus, the court need not address whether the TSAA violates the Commerce Clause. While making no specific legal findings herein, the court notes that at least two other courts have dismissed Commerce Clause claims challenging qualifying statutes. *See Star Scientific, Inc. v. Beales,* 278 F.3d 339 (4th Cir.2002); *PTI v. Philip Morris, Inc.,* 100 F.Supp.2d 1179, 1201 (C.D.Cal.2000).

Notably, another district court reached the same conclusion in *Forces Action Project LLC v. California,* No. C 99-0607 MJJ, Order (N.D.Cal. Jan. 15, 2002). There, several smokers' rights groups and approximately 400 individual smokers sued various parties to the MSA. The plaintiffs sought to amend their complaint to include a claim that the M.S.A. § violates the Commerce Clause. The district court held that such an amendment would be futile:

> [P]laintiffs do not provide [the] court with any indication how the M.S.A. § discriminates, on its face, between out-of-state and in-state goods. Even if they had, such an allegation would be contrary to the terms of the M.S.A. § which appears to apply equally over all states, making no distinction based on the origin of the cigarette. In addition, there is no indication why the higher prices allegedly caused by the M.S.A. § burden commerce.

Id. at 13.[4]

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4. With respect to the issue of shifting costs to consumers, the Ninth Circuit addressed a similar issue in *Table Bluff Reservation (Wiyot Tribe) v. Philip Morris, Inc.,* 256 F.3d 879 (9th Cir.2001). In *Table Bluff,* twenty Indian tribes (the "Tribes") filed a class action complaint against certain tobacco companies that are M.S.A. § parties. *Id.* at 881. The Tribes alleged, among other things, that increased cigarette prices that resulted from the M.S.A. § resulted in a due process violation. *Id.* at 885. The Ninth Circuit rejected this argument, stating that "no constitutional injury occurs when a manufacturer passes on higher costs in the form of price increases." *Id.* While

(Cont'd)

Similarly, the court here finds that Plaintiffs have failed to state a cause of action that the M.S.A. § violates the Commerce Clause. Moreover, the court need not grant leave to amend, as the complaint is not merely deficient. Accordingly, the court will dismiss Count II of Plaintiffs' complaint.

C. *Compact Clause*

Finally, in Count III of the Complaint, Plaintiffs allege that the M.S.A. § violates the Compact Clause of the Constitution, which provides that "no State shall, without the consent of Congress, . . . enter into any Agreement or Compact with another State." U.S. Const. art. I, § 10, cl. 3. Supreme Court precedent limits the applicability of the Compact Clause "to the formation of any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States." *Virginia v. Tennessee,* 148 U.S. 503, 519, 13 S.Ct. 728, 37 L.Ed. 537 (1893); *see also Northeast Bancorp., Inc. v. Board of Governors of the Fed. Res. Sys.,* 472 U.S. 159, 175-76, 105 S.Ct. 2545, 86 L.Ed.2d 112 (1985); *United States Steel Corp. v. Multistate Tax Comm'n,* 434 U.S. 452, 471, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978); *New Hampshire v. Maine,* 426 U.S. 363, 369, 96 S.Ct. 2113, 48 L.Ed.2d 701 (1976).

(Cont'd)

Table Bluff did not involve a Commerce Clause challenge to the MSA, the court here believes that the language is relevant. Simply because the M.S.A. § result in higher costs to consumers, which is the sum and substance of Plaintiffs' position, does not mean that there was a violation of the Commerce Clause.

Appendix B

The Third Circuit has not addressed whether the M.S.A. § violates the Compact Clause, however, the Fourth Circuit addressed the question in *Star Scientific, Inc. v. Beales,* 278 F.3d 339 (4th Cir.2002). There, an NPM challenged Virginia's qualifying statute as well as the MSA. *Id.* at 343. The district court dismissed the plaintiffs' complaint, and the Fourth Circuit affirmed. Addressing the Compact Clause challenge, the court found that the M.S.A. § contains "a horizontal aspect . . . that establishes a compact among the states, implicating the Compact Clause." *Id.* at 360. However, the court went on to hold that the compact did not encroach upon federal power. *Id.* Specifically, the Fourth Circuit determined that the states that are parties to the M.S.A. § are not exercising any powers that they could not exercise independently, and the M.S.A. § leaves open the potential for Congress to regulate tobacco. *Id.*

In the case at bar, Plaintiffs assert that the M.S.A. § violates the Compact Clause first "at the expense of the Sherman Act and the Commerce Clause." (Pls. Opp. Br. at 37.) The court has already determined that it will dismiss Plaintiffs' Sherman Act and Commerce Clause claims, therefore this argument is without merit. Plaintiffs also rely heavily on the MSA's provision that creates an administrative body. However, as noted by the Fourth Circuit in *Star Scientific,* "the Supreme Court [has] upheld a compact resulting in reciprocal state legislation and establishing an administrative body to coordinate State taxation of certain entities." *Id.* (citing *Multistate Tax Comm'n.,* 434 U.S. at 472-73, 98 S.Ct. 799). Plaintiffs attempt to differentiate the facts here from those in *Multistate Tax Commission* which the Fourth Circuit relied upon in *Star Scientific.* However,

the court finds the Fourth Circuit's reasoning to be persuasive. Moreover, granting leave to amend would be futile, as there is no set of facts that Plaintiffs could plead to properly allege that the M.S.A. § violates the Compact Clause. Accordingly, the court will also dismiss Count III of Plaintiffs' complaint.

IV. *Conclusion*

Defendants are immune from antitrust liability pursuant to the *Noerr-Pennington* doctrine because the M.S.A. § arose out of proceedings in which Defendants acted as petitioners. Thus, Plaintiffs have failed to state a claim for a violation of the Sherman Act, and the court will dismiss Count I of Plaintiffs' complaint. Furthermore, Plaintiff can prove no set of facts that will establish that the M.S.A. § violates either the Commerce Clause or the Compact Clause of the United States Constitution. Accordingly, the court will dismiss Counts II and III of Plaintiffs' complaint. An appropriate order will issue.

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DENYING PETITION FOR REHEARING DATED SEPTEMBER 3, 2003

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 02-2906

ROBERT MARIANA; MICHAEL J. MCFADDEN;
KAREN M. MORAN; EDWARD M. NANKERVIS,

Appellants

v.

D. MICHAEL FISHER, in his official capacity as Attorney General of the Commonwealth of Pennsylvania;
LARRY WILLIAMS, in his official capacity as Secretary of Revenue of the Commonwealth of Pennsylvania

SUR PETITION FOR REHEARING

Present: SCIRICA, Chief Judge, SLOVITER, NYGAARD, ALITO, ROTH, McKEE, BARRY, AMBRO, and FUENTES, SMITH, CHERTOFF and ALARCÓN*, Circuit Judges

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* Hon. Arthur L. Alarcón, Senior Judge, United States Court of Appeals for the Ninth Circuit, sitting by designation, as to panel rehearing only.

Appendix C

The petition for rehearing filed by Appellants, Robert Mariana, Michael J. McFadden, Karen M. Moran and Edward N. Nankervis, in the above-entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court en banc, the petition for rehearing is denied.

By the Court,

s/ [illegible]
Circuit Judge

Dated: September 3, 2003

APPENDIX D — RELEVANT PROVISIONS OF THE PENNSYLVANIA TOBACCO SETTLEMENT AGREEMENT ACT

ACT 35 P.S. § 5673

§ 5673. Definitions

* * *

"Tobacco product manufacturer."

(1) A person that after the date of enactment of this act directly and not exclusively through any affiliate:

(i) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where the importer is an original participating manufacturer, as that term is defined in the Master Settlement Agreement, that will be responsible for the payments under the Master Settlement Agreement with respect to the cigarettes as a result of the provisions of subsection II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement and provided that the manufacturer of the cigarettes does

not market or advertise the cigarettes in the United States);

(ii) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(iii) becomes a successor of a person described in subparagraph (i) or (ii).

(2) The term shall not include an affiliate of a tobacco product manufacturer unless the affiliate itself falls under paragraph (I)(i), (ii) or (iii).

"Units sold." The number of individual cigarettes sold in this Commonwealth by the applicable tobacco product manufacturer during the year in question, as measured by taxes collected by the Commonwealth on packs, or "roll-your-own" tobacco containers, bearing the tax stamp of the Commonwealth required under section 1215 of the act of March 4, 1971 (P.L. 6, No. 2), known as the Tax Reform Code of 1971.[1] The Department of Revenue shall promulgate such regulations as are necessary to ascertain the amount of State tax paid on the cigarettes of such tobacco product manufacturer for each year.

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1. 72 P.S. § 8215.

Appendix D

ACT 35 P.S. § 5674

§ 5674. Requirements

(a) General rule.—Any tobacco product manufacturer that sells cigarettes to consumers within this Commonwealth after the effective date of this act shall do one of the following:

(1) Become a participating manufacturer as defined in the Master Settlement Agreement and generally perform its financial obligations under the Master Settlement Agreement.

(2) Place into a qualified escrow fund by April 15 of the year following the year in question the following amounts, as the amounts are adjusted for inflation:

(i) 2000 – $.0104712 per unit sold after the effective date of this act.

(ii) For each of 2001 and 2002 – $.0136125 per unit sold.

(iii) For each of 2003 through 2006 – $.0167539 per unit sold.

(iv) For each of 2007 and each year thereafter – $.0188482 per unit sold.

(b) Funds in escrow.—A tobacco product manufacturer that places funds into escrow under subsection (a)(2) shall receive the interest or other appreciation on such funds as earned. The funds themselves shall be released from escrow only under the following circumstances:

(1) To pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the Commonwealth or any releasing party located or residing in this Commonwealth. Funds shall be released from escrow under this paragraph in the order in which they were placed into escrow and only to the extent and at the time necessary to make payments required under such judgment or settlement.

(2) To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the Commonwealth's allocable share of the total payments that the manufacturer would have been required to make in that year under the Master Settlement Agreement had it been a participating manufacturer, as such payments are determined pursuant to section IX(i)(2) of the Master Settlement Agreement and before any of the adjustments or offsets described in section IX(i)(3) of the Master Settlement Agreement other than the inflation

adjustment, the excess shall be released from escrow and revert back to such tobacco product manufacturer.

(3) To the extent not released from escrow under paragraph (1) or (2), funds shall be released from escrow and revert back to the tobacco product manufacturer 25 years after the date on which they were placed into escrow.

* * * *

(2)

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No. 03-806

In the Supreme Court of the United States

ROBERT MARIANA, MICHAEL J. MCFADDEN, KAREN M. MORAN, AND EDWARD M. NANKERVIS,
Petitioners

v.

GERALD J. PAPPERT, IN HIS OFFICIAL CAPACITY AS ACTING ATTORNEY GENERAL OF THE COMMONWEALTH OF PENNSYLVANIA; AND GREGORY J. FAJT, IN HIS OFFICIAL CAPACITY AS SECRETARY OF REVENUE OF THE COMMONWEALTH OF PENNSYLVANIA,
Respondents

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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DATE: January 5, 2004

QUESTIONS PRESENTED

1. May state officials who file and settle a lawsuit be petitioning parties for purposed of *Noerr-Pennington* immunity from antitrust claims.

2. If state regulation at the manufacturer level results in higher prices that are passed on to consumers, do consumers have standing to challenge the regulation's constitutionality under the Commerce Clause and Compact Clause?

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STATEMENT OF THE CASE

Petitioners, four Pennsylvania cigarette smokers, brought this action to attack Pennsylvania's participation in the Master Settlement Agreement which resolved the litigation brought by 46 States, including Pennsylvania, against the major American manufacturers of cigarettes. Petitioners alleged that the Master Settlement Agreement violated the Sherman Act, 15 U.S.C. §1; and the Constitution's Interstate Commerce Clause, U.S. Const., Art. I, §8, cl. 3 and Compacts Clause, *Id.*, Art. I, §10, Cl. 3. Respondents are Pennsylvania's Acting Attorney General Gerald J. Pappert and Secretary of Revenue, Gregory S. Fajt.[1] Other parties to the Master Settlement Agreement — the major cigarette Manufacturers — had already successfully defended against similar antitrust claims. *See A.D. Bedell Wholesale Co. v. Philip Morris, Inc.*, 263 F.3d 239 (3d Cir. 2001), *cert. denied*, 122 S.Ct. 813 (2002), and were not named as parties.

The respondents moved to dismiss the complaint, and the district court granted their motion. The court concluded that the antitrust claim against the respondents was barred by the *Noerr-Pennington* immunity doctrine "[b]ecause the [Master Settlement Agreement] arose out of a petition in proceedings before other governmental agencies authorized to resolve such

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[1]Mr. Pappert and Mr. Fajt have been substituted for their predecessors D. Michael Fisher and Larry Williams pursuant to Supreme Court Rule 35.3.

issues."[2] App. 48a. The district court briefly considered whether the respondents' conduct might also be protected from antitrust liability as state action under *Parker v. Brown*, 317 U.S. 341 (1943), but rejected that argument on the strength of dicta from the Court of Appeals' earlier decision in *Bedell*. App. 48a-50a. The district court did, however, reject the Commerce and Compacts Clause claims, concluding that the Master Settlement Agreement did not burden commerce, did not "encroach upon or interfere with the just supremacy of the United States," quoting *Virginia v. Tennessee*, 148 U.S. 503, 519 (1893), App. 58a, and was indistinguishable from similar multi-state arrangements which this Court has upheld. App. 59a, citing *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978).

The Court of Appeals affirmed. Although it acknowledged that the case before it "differ[ed] from *Bedell* in that the parties are different, " App. 26a, and that the Court in that case may "have placed too little significance on the States' role in the implementation of the MSA," App. 25a, the Court of Appeals held that the State Officials were not entitled to *Parker* immunity because "it [felt] bound by *Bedell* from reaching a different conclusion." App. 26a. The Court did hold, however, that the respondents enjoyed *Noerr-Pennington* immunity. The Court observed that "Defendant Fisher was among the dozens of Attorneys General across the country who filed suit against the tobacco companies, effectively petitioning the judiciary. In *Trucking*

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[2] *E.R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961) and *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

Unlimited, [California Motor Transport Co. & Trucking Unlimited, 404 U.S. 508 (1992)], the Supreme Court made explicit that the *Noerr-Pennington* doctrine immunizes petitioning directed at any branch of government, including the executive, legislative, judicial, and administrative agencies. 404 U.S. at 510, 92 S.Ct. 609. In *Bedell* we held that the settlement that arose from the tobacco lawsuits was petitioning for *Noerr-Pennington* purposes. 263 F.3d at 252." App. 16a. The Court said that petitioners "provide[d] no persuasive authority" that petitioning immunity could not apply to a public entity, and the Court knew "of no Supreme Court or federal appellate case to this effect." App. 19a.

The Court of Appeals went on to conclude that the petitioners, as cigarette smokers, lacked standing to pursue to Constitutional claims under the Commerce and Compacts Clauses. Citing to this Court's precedents and its own, the Court of Appeals held that the petitioners failed to demonstrate either "constitutional" or "prudential" standing because they failed to allege any injury in fact, asserting only injuries suffered by cigarette manufacturers. App. 27a-32a.

REASONS FOR DENYING THE WRIT

Petitioners have offered no reason why the Court should review the case. They have pointed to no split in authority among the circuit courts of appeals or to any unsettled issue of law as to which the Court should provide guidance. They do argue in their petition that the court of appeals was wrong and misapplied the law, but the correction of error is not alone a reason for the Court to grant the petition. See Sup. Ct. R. 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of an erroneous factual findings or the misapplication of a properly stated rule of law.")

Here, both with respect to its holdings on the antitrust claim and the constitutional ones, the Court of Appeals has properly stated the rules of law: as to the former, the *Noerr-Pennington* doctrine, and as to the latter, the Court's *Lujan* case on constitutional standing.[3] There is no division of opinion on the issues among the federal courts. Similar or identical challenges to the Master Settlement Agreement have been made and rejected in the following cases, in many of which petitions for certiorari have been rejected by the Court: *See A.D. Bedell Wholesale Co. v. Philip Morris, Inc.*, 263 F.3d 239 (3d Cir. 2001), *cert. denied*, 122 S.Ct. 813 (2002)[Corporate parties to the Master Settlement agreement entitled to *Noerr-Pennington* Immunity; *Starr Scientific, Inc. v. Beales*, 278 F.3d 339 (4th Cir.), *cert. denied sub nom. Star Scientific, Inc. v. Kilgore*, __ U.S. ___, 71 U.S.L.W. 3234 (2002)(No violation of Commerce or Compacts Clauses); *North American Trading Co. v. Nat. Ass'n of Attorneys General*, No. 01-CV-01600 (D.D.C.

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[3] *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992).

2002) (Parties lacked standing to assert constitutional claims); *PTI, Inc. v. Philip Morris, Inc.*, 100 F.Supp.2d 1179 (C.D. Cal. 2000)(Private and state defendants entitled to immunity from antitrust claims, and no violation of Commerce or Compacts Clauses); *Hise v. Philip Morris, Inc.*, 46 F.Supp.2d 1201 (N.D. Okla. 1999), *aff'd*, 208 F.3d 226 (10th Cir., 2000), *cert. denied*, 531 U.S. 959 (2000)(antitrust and constitutional claims dismissed); *Forces Action Project, LLC v. California*, 61 Fed. Appx. 72 (9th Cir. 2003)(affirming refusal to allow amendment to assert antitrust claims - -constitutional claims had earlier been dismissed).

There is no reason to revisit these issues in this case, and the petition for writ of certiorari should be denied.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted,

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IN THE

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Petitioners,

v.

GERALD J. PAPPERT, in his official capacity as Acting Attorney General of the Commonwealth of Pennsylvania; and GREGORY J. FAJT, in his official capacity as Secretary of Revenue of the Commonwealth of Pennsylvania,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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PETITIONERS' REPLY ARGUMENT IN SUPPORT OF WRIT

Respondents argue that Petitioners have pointed to no split in authority among the circuit courts of appeals or to any unsettled issue of law as to which the Court should provide guidance. Resp. Brf. 4. The opposition overlooks the precedent cited in the Petition, particularly that which conflicts with the decision below.[1] The Court is not faced merely with erroneous factual findings or a misapplication of a properly stated rule of law. Respondents' attempt to recast the Petition and the issues before the Court in that light in an effort to demonstrate that no conflict exists is misplaced.

With respect to Petitioners' Sherman Act claims, Respondents' status as persons who petitioned the Commonwealth's judiciary and legislature to adopt the MSA and TSAA is irrelevant to the issues presented. Restraints on competition that are adopted or sanctioned by a State must satisfy the state action requirements articulated by the Court in *Parker v. Brown*, 317 U.S. 341 (1943), and *California Retail Liq. Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). That state officials, or any other persons, are immune under the *Noerr-Pennington* doctrine with respect to their act of petitioning the Commonwealth to adopt or sanction the restraints at issue cannot, and does not, immunize

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1. Respondents filed their opposition on January 5, 2004, one day before the Court of Appeals for the Second Circuit issued its decision in *Freedom Holdings, Inc. v. Spitzer*, No. 02-7492, 2004 WL 26498 (2d Cir. Jan. 6, 2004). As pointed out in Petitioners' Supplemental Brief, the decisions of the Third Circuit below and the Second Circuit in *Freedom Holdings* present a direct conflict of law among circuit courts presented with identical facts and, thus, may more properly be described as a "complete" or irreconcilable conflict.

the restraints themselves or their subsequent implementation and enforcement by state officials. The Third Circuit's ruling to the contrary in this case is in plain conflict with the decisions of the Court and other circuit courts and federal courts that have addressed these issues. *Columbia v. Omni Outdoor Adver. Inc.*, 499 U.S. 365, 383 (1991) (*Parker* applies to State's action implementing restraint of trade; *Noerr-Pennington* protects right to petition for restraint of trade); *Freedom Holdings, Inc. v. Spitzer*, No. 02-7492, 2004 WL 26498 (2d Cir. Jan. 6, 2004) (*Noerr-Pennington* doctrine applies to pre-adoption and pre-legislation advocacy for restraint, *Parker* doctrine applies to restraint State adopts in response to such advocacy, *i.e.*, results of petitioning); *In re Airport Car Rental Antitrust Litig.*, 693 F.2d 84, 87 (9th Cir. 1982) (state official's liability governed by *Parker*; liability of private entity for requesting restraint governed by *Noerr-Pennington*); *see also Nursing Registry, Inc. v. Eastern North Carolina Reg. Emer. Med Servs.*, 959 F. Supp 298 (E.D.N.C. 1997) (claims against private parties analyzed under *Noerr-Pennington*, claims against government officials analyzed under *Parker*); *Bright v. Ogden City*, 635 F. Supp. 31, 33 (D. Utah 1985) (State may lack state action immunity under *Parker* even when private actors are immune from liability under *Noerr-Pennington*).

Respondents rely on several circuit court and district court cases in arguing that "similar or identical" challenges to the MSA have been made and rejected. Resp. Brf. 4. If Respondents' reliance were properly placed, then such fact would only confirm that the present conflict reaches beyond the circuit courts and decisions cited herein. None of the cases cited by Respondents, however, deals with the precise Sherman Act claims and issues presented. Namely, none of the cases addressed or decided whether state officials and

the restraints of trade they agree to in a settlement agreement may be immune from scrutiny under the antitrust laws, notwithstanding that the state officials fail actively to supervise the private anticompetitive conduct that the settlement sanctions.

Respondents cite to, and rely exclusively on, the Court's decision in *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992), as grounds for denying review of the constitutional standing issues presented. Respondents' opposition offers no explanation or discussion of the *Lujan* case or its application, particularly given the conflict presented in the Petition. Moreover, *Lujan* did not involve standing under the Commerce Clause, nor the relevant standard for determining standing on a motion to dismiss. The issue in *Lujan* was whether an environmental group sufficiently demonstrated standing to challenge federal legislation on a motion for summary judgment.

When a State regulates suppliers in a manner that violates the Commerce Clause, the suppliers *as well as customers of their products and services* have standing to challenge the state regulation under the Constitution. *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276, and *Huish Detergents, Inc. v. Warren Cty.*, 214 F.3d 707 (6th Cir. 2000). The decision below does not merely present a misapplication of a properly stated rule of law; the decision improperly states the applicable rule of law and is in conflict with the decisions of the Court and at least one other Court of Appeals.

CONCLUSION

The petition for a writ of certiorari should be granted.

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No. 03-806

Supreme Court, U.S.
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IN THE

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ROBERT MARIANA, MICHAEL J. McFADDEN, KAREN M. MORAN, and EDWARD M. NANKERVIS,

Petitioners,

v.

D. MICHAEL FISHER, in his official capacity as Attorney General of the Commonwealth of Pennsylvania; and LARRY WILLIAMS, in his official capacity as Secretary of Revenue of the Commonwealth of Pennsylvania,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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STATEMENT OF REASONS FOR FILING SUPPLEMENTAL BRIEF

On December 2, 2003, Petitioners filed their petition for writ of certiorari. On January 6, 2004, the United States Court of Appeals for the Second Circuit issued its decision in *Freedom Holdings, Inc. v. Spitzer*, No. 02-7492, 2004 WL 26498 (2d Cir. Jan. 6, 2004). The factual allegations and Sherman Act issues that were before the court in *Freedom Holdings* are *identical* to those that were before the Court of Appeals for the Third Circuit in this case. The decision in *Freedom Holdings* is in direct and complete conflict with the decision below. Petitioners file this supplemental brief pursuant to Rule 15.8 of the Court's Rules, because the decision in *Freedom Holdings* was not available at the time Petitioners filed their Petition.

DIRECT CONFLICT AMONG THE CIRCUITS DESPITE IDENTICAL ISSUES OF FACT AND LAW

In *Freedom Holdings*, importers and sellers of tobacco products brought an action in the United States District Court, Southern District of New York, under the Sherman Act and Commerce Clause, to challenge legislation enacted by the State of New York in connection with the MSA.[1] App. 1a. The plaintiffs alleged that the MSA's Renegade Clause and the Escrow Statutes create an output cartel that protects the Majors' market share and prevents price competition from SPMs and NPMs. App. 5a-11a. The object of the complaint's challenge was complementary legislation (hereafter "Contraband Laws") that the State of New York (and other

1. Capitalized terms undefined herein have the meaning ascribed to them in the Petition.

MSA States) enacted to enhance enforcement of the Escrow Statutes and the effectiveness of these restraints of trade. App. 11a-12a.[2]

The defendants in *Freedom Holdings*, the New York State Attorney General and the Commissioner of Taxation and Finance of New York, moved to dismiss the complaint on several grounds. The district court granted the motion, finding *inter alia* that the anticompetitive scheme enforced by New York State through the Contraband Laws constituted unilateral state action that did not conflict with, and was not preempted by, the Sherman Act. App. 30a.[3]

On appeal, the Court of Appeals in *Freedom Holdings* initially followed the reasoning of the Court of Appeals in this case. Namely, the court found that the Renegade Clause and Escrow Statutes indeed restrain trade in violation of the Sherman Act, and the Contraband Laws serve to further implement these restraints. App. 37a-39a. Similarly, the court

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2. Contraband Laws, including New York's Contraband Laws, provide that no person may sell or affix state cigarette excise tax stamps to packages of cigarettes manufactured by NPMs that have failed to make escrow payments required under the Escrow Statutes ("Non-compliant NPMs"). Cigarettes of Non-compliant NPMs are deemed contraband under the Contraband Laws and subject to immediate seizure and forfeiture. Persons dealing in such cigarettes are subject to business license revocation proceedings, as well as criminal prosecution. App. 13a-15a.

3. The district court also dismissed the Commerce Clause claims, holding that plaintiffs did not allege facts demonstrating that the Contraband Laws discriminated against interstate commerce. App. 2a-3a. Dismissal of the Commerce Clause claims was affirmed on appeal. *Id.* The Court of Appeals, however, reversed the dismissal of the antitrust claims. *Id.*

in *Freedom Holdings* agreed with the Third Circuit, in finding that the subject restraints of trade are not shielded from scrutiny under the *Parker* state action doctrine. App. 51a-52a. In short, the Renegade Clause, Escrow Statutes and Contraband Laws restrict output and price competition from SPMs and NPMs, leaving the Majors free to raise their prices to supracompetitive levels without any oversight or control from the MSA States. App. 37a-38a, 53a.

Significantly, however, the Court of Appeals for the Second Circuit departed from the Third Circuit's findings and legal conclusions in this case with respect to the *Noerr-Pennington* doctrine. The Court in *Freedom Holdings* held that *Noerr-Pennington* does not shield the defendants or the restraints at issue from scrutiny under the Sherman Act. App. 54a-55a. In direct conflict with the Third Circuit's holding in this case, the court in *Freedom Holdings* held that the *Noerr-Pennington* doctrine applies only to immunize the petitioning process — not the state-adopted restraints that result from such petitioning, or the state officials responsible for implementing and enforcing such restraints. *Id.* The court in *Freedom Holdings* went on to reverse the district court and hold that, under the facts alleged, the plaintiffs stated a claim under the Sherman Act that was not subject to dismissal on antitrust immunity grounds. App. 55a.

There now exists a direct and complete conflict among the Courts of Appeal with respect to an important legal issue under the United States antitrust laws. Petitioners argue in their Petition that the Court of Appeals for the Third Circuit erred in relying on the *Noerr-Pennington* doctrine to dismiss their antitrust claims in this case. The Court of Appeals for the Second Circuit in *Freedom Holdings*, when

presented with identical facts and similar claims, has held that reliance on *Noerr-Pennington* to dismiss such claims would be in error. The legal issues presented on the Petition and the current conflict can only be resolved by certiorari to this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

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APPENDIX

APPENDIX

United States Court of Appeals,
Second Circuit.

FREEDOM HOLDINGS INC., d/b/a North American Trading Company, and International Tobacco Partners, Ltd., on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

Eliot SPITZER, in his official capacity as Attorney General of the State of New York, and Arthur J. Roth, in his official capacity as Commissioner of Taxation and Finance of the State of New York, Defendants-Appellees.

No. 02-7492.

Argued: Aug. 26, 2002.
Decided: Jan. 6, 2004.

Before: WINTER, *SACK*, and SOTOMAYOR, Circuit Judges.

Judge *SACK* concurs in a separate opinion.

WINTER, Circuit J.

This appeal involves a challenge to New York legislation enacted pursuant to the settlement agreement of a host of various lawsuits brought by most of the states against the major tobacco manufacturers. Freedom Holdings Inc. and International Tobacco

Partners, Ltd.—companies that import cigarettes for resale in New York from foreign manufacturers who are non-parties to the settlement agreement—appeal from Judge Hellerstein's dismissal of their complaint pursuant to *Fed.R.Civ.P. 12(b)(6)*. The appellees are Eliot Spitzer, Attorney General of the State of New York, and Arthur J. Roth, Commissioner of Taxation and Finance of the State of New York, both officials with responsibility for enforcing the laws being challenged, *New York Tax Law § § 480-b, 481*, subdiv. 1(c), and 1846 (the "Contraband Statutes").

The Contraband Statutes were passed in connection with the Master Settlement Agreement (the "MSA") executed by the country's four major tobacco manufacturers and most of the states. Appellants allege—and at this stage we must assume their allegations to be true—that New York's Contraband Statutes enforce a market-sharing and price-fixing cartel embodied in the MSA that allows the major tobacco manufacturers to charge supra-competitive prices, in exchange for sharing their monopoly profits with the State of New York.

Appellants challenge the Contraband Statutes on the grounds that: (i) they violate the Commerce Clause, *U.S. Const. art. I § 8, cl. 3*; (ii) they are in conflict with Section 1 of the Sherman Act, *15 U.S.C. § 1*, and therefore preempted; and (iii) New York's selective nonenforcement as to wholesalers and importers on Native American reservations violates the Commerce Clause and the Equal Protection Clause.

Appellees moved to dismiss the complaint pursuant to *Fed.R.Civ.P. 12(b)(1)* and *12(b)(6)*. The district court granted the motion, holding that: (i) the Commerce Clause is not violated because the Contraband Statutes do not favor local interests

over out-of-state interests; (ii) the Contraband Statutes do not violate the antitrust laws because they are unilateral state action and are thus not prohibited by the Sherman Act under *Parker v. Brown, 317 U.S. 341 (1943)*; and (iii) under *Washington v. Confederated Bands and Tribes of the Yakima Indian Nation, 439 U.S. 463 (1979)*, and *New York Ass'n of Convenience Stores v. Urbach, 92 N.Y.2d 204 (1998)*, appellants failed to state a valid equal protection claim.

Appellants renew their claims on appeal. We affirm the dismissal of the Commerce Clause claim. We reverse with respect to the Sherman Act claim because, based on the complaint's allegations, the *Parker* state action immunity doctrine does not immunize the Contraband Statutes from preemption by the Sherman Act. In that regard, we reach the same conclusion as did the Third Circuit in *A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239 (3d Cir.2001)*. We remand the selective enforcement claim to allow the district court to elaborate on its ruling and appellants to amend their complaint. We begin with a Table of Contents.

BACKGROUND

a) *The Master Settlement Agreement and Related New York Legislation*

We begin with a summary of relevant provisions of the MSA and related New York legislation as alleged in appellants' complaint. Because this appeal is from a dismissal on the pleadings, we assume the factual allegations of the complaint to be true.

Appendix

1. *Master Settlement Agreement*

In 1997, the State, City, and the counties of New York filed suit against the country's major cigarette manufacturers. *See State v. Philip Morris, Inc., 179 Misc.2d 435, 686 N.Y.S.2d 564 (N.Y.Sup.Ct.1998)*. The action sought to recover damages related to the costs borne by these various political units of treating smoking-related illnesses and to impose restrictions on the cigarette manufacturers' sales, marketing, advertising, and disclosure practices. Similar actions were brought by 45 other states. These lawsuits were settled by execution of the MSA in November 1998. The settlement of the New York lawsuit was approved by the Supreme Court of New York, New York County, in a consent decree signed on December 23, 1998. *See 179 Misc.2d at 451*.

The MSA was initially executed by the four dominant (alleged to account for 98% of cigarette sales at the time) cigarette manufacturers, Philip Morris, Lorrilard Tobacco, Brown & Williamson, and R.J. Reynolds (the "Original Participating Manufacturers," hereinafter "OPMs"), and by forty-six states (including New York), the District of Columbia, Puerto Rico, American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands (the "Settling States"). Thirty-three additional, and smaller, tobacco companies (the "Subsequent Participating Manufacturers," hereinafter "SPMs" and, together with the OPMs, the "Participating Manufacturers," hereinafter "PMs") became parties to the MSA. It is alleged that, at that time, the PMs were responsible for 99% of cigarette sales.[1]

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1. It is unclear whether this market share is of sales nationwide or just in New York.

Appendix

In general, the MSA imposes numerous restrictions and requirements in connection with the PMs' sales, marketing, advertising, lobbying, research, education, and disclosure practices. *See* MSA at 15-37. It also requires annual payments by the OPMs to the Settling States,[2] *see* MSA at 46-48, and releases the PMs from future claims by the Settling States, *see* MSA at 11-12, 93-101. Any non-participating cigarette manufacturer ("Non-Participating Manufacturer," hereinafter "NPM") may become a SPM by signing the MSA and making the payments that would have been due had it been a signatory as of the MSA execution date. MSA at 9, 13.

The OPMs' overall annual payment obligation is specified in the MSA.[3] *See* MSA at 47-48. This obligation is allocated among the OPMs in accordance with their relative market shares. *See* MSA at 48. Annual payments to the Settling States are to be adjusted according to changes in the overall volume of cigarette sales. *See* MSA at 48 & Exhibit E. A significant reduction in sales will therefore lead to a reduction in payments and state revenue.

We turn now to the specific provisions of the MSA that give rise to the present action. In addition to the link between overall cigarette sales and payments to the Settling States noted above, there are provisions for changes in the payments required of

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2. Receipt of settlement payments is allocated among the Settling States pursuant to a protocal set forth in Exhibit U to the MSA.

3. The nationwide base payments begin at $4.5 billion for the year 2000 and gradually increase to $9 billion in the year 2018 and each year thereafter.

particular companies due to changes in their market share. One such provision applies to market share losses by any OPM to other PMs. In general, an OPM losing market share pays less to the states; an OPM gaining market share pays more. *See* MSA at 46-47. Future payment obligations of SPMs—those arising after the initial payment made upon joining the MSA—occur only if a particular manufacturer's market share rises above the greater of (i) 100% of its 1998 market share, or (ii) 125% of its 1997 market share. Any future payments owed by SPMs are at a rate approximately equal to that paid by the OPMs. *See* MSA at 65-68.

Another provision governs the reduction of payments where market share is lost by an OPM to NPMs. This decrease is styled by the MSA as the "Non-Participating Manufacturer Adjustment" (the "NPM Adjustment") and reduces required payments if there are any losses of market share experienced by the OPMs as a result of "disadvantages" arising out of the MSA. MSA at 49-52. Given the allegations of this complaint, not to mention the name of the NPM Adjustment, we must assume that one of the contemplated "disadvantages" is price competition from NPMs. Because the NPM Adjustment trebles the decrease in payment obligations when an OPM loses more than 2% due to a "disadvantage," *see* MSA at 49, the loss of revenue to the Settling States from an NPM Adjustment is potentially substantial.[4]

Appellants allege that these market-share provisions constitute an "output cartel" that prevents price competition, leads to monopoly prices, and encourages Settling State to protect

4. If the OPM's market share loss exceeds 16 2/3 %, the decrease in payment obligations is somewhat less than the treble reduction for losses between 2% and 16 2/3 %. *See* MSA at 50.

the cartel in order to preserve the revenue flow to the States. They claim that the effect of the market-share provisions is to deter competition among and between OPMs and SPMs as follows. Increases in a PM's market share would lead to increased payment obligations that offset or exceed profits from increased sales. The prospect of such increased obligations negates the incentive of PMs to compete through price competition. More than this, appellants allege that this disincentive induces cigarette manufacturers to follow price increases by a major manufacturer because there is little to be gained—increased market share will be offset or exceeded by increased payment obligations—by maintaining a lower price. Finally, they allege that large price and revenue increases have resulted from the MSA.

Of course, the described market-share provisions alone would reduce competition only until NPMs, who have not agreed to pay anything to the Settling States, charged less for their cigarettes and eventually gained market share at the expense of the PMs. However, the NPM Adjustment substantially reduces the payment obligations (trebled reductions for losses over 2%) of the OPMs in the face of such competition, providing incentives to the Settling States to protect the market share of the OPMs.

2. *New York Escrow Statute*

Under the MSA, the Settling States do not have to sit idly by while their MSA tobacco revenue is reduced over time by competition from NPMs. A Settling State can immunize itself from downward NPM Adjustments by enacting and "diligently enforc[ing]" a form "Escrow Statute"—attached to the MSA, *see* MSA at 53 & Exhibit B—requiring any NPM either: (i) to join the MSA (becoming a SPM and making future

settlement payments accordingly with respect to any increased market share), or (ii) on a regular basis to place into a 25-year rolling escrow account funds alleged to be greater than the amount such manufacturer would pay were it a SPM under the MSA. All of the Settling States have enacted Escrow Statutes. *See* Compl. ¶ 19, at 10.

New York enacted its Escrow Statute on November 27, 1999. *See N.Y. Pub. Health Law § 1399-nn* to *1399-pp (2002)*. The Statute provides that any tobacco product manufacturer selling cigarettes directly or indirectly to consumers within New York shall either become a PM under the MSA, *see N.Y. Pub. Health Law § 1399-pp(1)*, or make escrow payments as though it were a SPM, *see N.Y. Pub. Health Law § 1399-pp(2)*.[5]

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5. New York's Escrow Statute provides in part as follows:

> Any tobacco product manufacturer selling cigarettes to consumers within the state (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the effective date of this article shall do one of the following:
>
> 1. become a participating manufacturer (as that term is defined in section II(jj) of the master settlement agreement) and generally perform its financial obligations under the master settlement agreement; or
>
> 2. (a) place into a qualified escrow fund by April fifteenth of the year following the year in question the following amounts (as such amounts are adjusted for inflation):
>
> (i) 1999: $ .0094241 per unit sold after the effective date of this section;

(Cont'd)

Appendix

(Cont'd)

(ii) 2000: $ .0104712 per unit sold;

(iii) for each of 2001 and 2002: $ .0136125 per unit sold;

(iv) for each of 2003 through 2006: $ .0167539 per unit sold;

(v) for each of 2007 and each year thereafter: $ .0188482 per unit sold.

(b) a tobacco product manufacturer that places funds into escrow pursuant to paragraph (a) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances:

(i) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the state or any releasing party located or residing in the state. Funds shall be released from escrow under this subparagraph: (A) in the order in which they were placed into escrow and (B) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(ii) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the state's allocable share of the total payments that such manufacturer would have been required to make in that year under the master settlement agreement (as determined pursuant to

(Cont'd)

Specifically, the statute requires that NPMs who sell cigarettes through a distributor, retailer, or similar intermediary place a per-pack fee into an escrow account that may be recovered by the NPM after twenty years if no such obligation has been incurred. The statute thus imposes a per-pack fee on NPM-manufactured cigarettes that adds to the resale price of the product. Although this fee does not expressly require the product to be sold at a particular price, the cost to NPMs of complying with the Escrow Statute is alleged to be higher than the cost to PMs of complying with the MSA. Compl. ¶ 20, at 10-11.

According to the complaint, the Escrow Statute, by compelling NPMs to make payments—either by joining the MSA or by complying with the Escrow Statute— according to increased market share, effectively relieves the OPMs of price competition. *See* Compl. ¶ ¶ 17-23, at 9-12. For example,

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(Cont'd)

> section IX(i)(2) of the master settlement agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that agreement other than the inflation adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or
>
> (iii) to the extent not released from escrow under subparagraph (i) or (ii) of this paragraph, funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

N.Y. Pub. Health Law § 1399-pp (2002).

appellants claim that the payments required (either under the MSA or Escrow Statute) of SPMs for increased market share are prohibitively high—amounting to "penalties"—given the lower operating profit margins of these manufacturers compared to the OPMs. Appellants' Br. at 13-14. Appellants further allege that escrow payments required of NPMs under the Escrow Statute are even more prohibitively expensive because, unlike payments pursuant to the MSA, they are not tax deductible. *Id.* at 15. Appellants describe this elimination of competition as creating an "output cartel." *Id.* at 20.

3. *New York's Contraband Statutes*

Of course, if the Escrow Statute were either fully complied with or fully enforced, the cartel alleged would be immune to price competition. However, appellants allege that the market share of PMs actually declined between 1999 and 2002 from 99% to approximately 96%. *See* Note 1, *supra*. They attribute that decline to price competition from foreign NPMs that do not comply with the Escrow Statute. This residual non-compliance is alleged to result from difficulties in enforcing the Escrow Statute, in particular against foreign manufacturers, such as those from whom appellants purchased cigarettes for resale.

Effective December 28, 2001, New York passed the Contraband Statutes in response to this threat. In Governor Pataki's words, this legislation was needed to "bolster the State's ability to diligently enforce" the Escrow Statute, and thus to "help protect the State from further [NPM] adjustments." Appellants' Br. at 18. To be sold lawfully in New York, cigarette packages need to bear a tax stamp affixed by a New York State cigarette

tax stamp agent. The Contraband Statutes add the requirements of the Escrow Statute to the "gatekeeper" functions already played by tax stamp agents. The Statutes label as contraband any cigarettes made by manufacturers that do not comply with the Escrow Statute. The effect alleged is to impose something analogous to an *in rem* liability on the cigarettes themselves, rendering them subject to seizure and forfeiture, in contrast to the *in personam* liability imposed on NPMs by the Escrow Statutes. Twenty-four of the Settling States have passed Contraband Statutes. *See* Appellants' Rule 28(j) letter.

It is the Contraband statutes, appearing in *Sections 480-b, 481(c)* and *1846 of the New York State Tax Law*, that are the object of appellants' challenge. The particulars of the Statutes are as follows. *Section 480-b* requires cigarette manufacturers to certify annually, to the New York State Commissioner of Taxation and Finance, the Attorney General of the State of New York, and the cigarette tax stamp agents (according to appellants, usually wholesalers[6] responsible for affixing New York State cigarette tax stamps on such manufacturer's cigarettes), that such manufacturer is either: (a) a PM making payments under the MSA (i.e. satisfying *Section 1399-pp(1)* of the Escrow Statute) or (b) in compliance with the escrow requirements of *Section 1399-pp(2)* of the Escrow Statute. *N.Y. Tax Law § 480-b(1). Section 480-b* also prohibits New York State cigarette tax stamp agents from affixing tax stamps to cigarettes if the relevant manufacturer has not provided the required certification or if the tax stamp agent has been notified by the Commissioner of Public Health

6. For purposes of this opinion, we use the terms "wholesalers" and "tax stamp agents" interchangeably.

that such manufacturer is in violation of the Escrow Statute. *N.Y. Tax Law § 480-b(2).*[7]

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7. *Section 480-b* provides in its entirety as follows:

§ 480-b. Prohibition against the stamping of certain cigarettes

1. Every tobacco product manufacturer as defined by section thirteen hundred ninety-nine-oo of the public health law whose cigarettes are sold for consumption in this state shall annually certify under penalty of perjury that, as of the date of such certification, such tobacco product manufacturer: (a) is a participating manufacturer as defined in subdivision one of section thirteen hundred ninety-nine-pp of the public health law; or (b) is in full compliance with subdivision two of section thirteen hundred ninety-nine-pp of the public health law. Such certification shall be executed and delivered to the commissioner, the attorney general and any agent who affixes New York state cigarette tax stamps to cigarettes of such tobacco product manufacturer, no earlier than the sixteenth day of April and no later than the thirtieth day of April of each year, and shall be accompanied by a list setting forth each of the cigarette brands of such tobacco product manufacturer sold for consumption in New York state. Agents shall retain such certifications for a period of five years.

2. An agent may not affix, or cause to be affixed, a New York state cigarette tax stamp to a package of cigarettes if either: (a) the tobacco product manufacturer of such cigarettes has not provided such agent with the certification required by subdivision one of this section; or (b) the commissioner has notified such agent that such tobacco product manufacturer is in violation of section thirteen hundred ninety-nine-pp of the public health law, or has filed a false certification under subdivision one of this

(Cont'd)

Appendix

Section 1846 provides for seizure and forfeiture of any cigarettes that are unstamped or have been stamped in violation of *Section 480-b. N.Y. Tax Law § 1846(a), (a-1).*[8] *Section*

(Cont'd)

> section, and such agent has not been notified by the commissioner that such violation has ceased.
>
> 3. The commissioner shall prescribe the form of the certification required to be filed pursuant to subdivision one of this section.

N.Y. Tax Law § 480-b (2002).

8. *Section 1846* provides, in pertinent part, as follows:

> *§ 1846.* Seizure and forfeiture of cigarettes
>
> (a) Whenever a police officer designated in *section 1.20 of the criminal procedure law* or a peace officer designated in subdivision four of section 2.10 of such law, acting pursuant to his or her special duties, shall discover any cigarettes subject to tax provided by article twenty of this chapter or by chapter thirteen of title eleven of the administrative code of the city of New York, and upon which the tax has not been paid or the stamps not affixed as required by such article or such chapter thirteen, they are hereby authorized and empowered forthwith to seize and take possession of such cigarettes, together with any vending machine or receptacle in which they are held for sale. Such cigarettes, vending machine or receptacle seized by a police officer or such peace officer shall be turned over to the commissioner. Such seized cigarettes, vending machine or receptacle, not including money contained in such vending machine or receptacle, shall be forfeited to the state. . . .
>
> (a-1) Whenever a police officer designated in *section 1.20 of the criminal procedure law* or a peace officer designated

(Cont'd)

481, subdiv. 1(c) authorizes imposition of civil penalties upon any manufacturer or agent violating *Section 480-b*. *N.Y. Tax Law § 481*, subdiv. 1(c).[9]

(Cont'd)

> in subdivision four of section 2.10 of such law, acting pursuant to his or her special duties, shall discover any cigarettes which have been stamped in violation of section four hundred eighty-b of this chapter, such officer is hereby authorized and empowered forthwith to seize and take possession of such cigarettes, and such cigarettes shall be subject to a forfeiture action pursuant to the procedures provided for in article thirteen-A of the civil practice law and rules, as if such article specifically provided for forfeiture of cigarettes seized pursuant to this section as a preconviction forfeiture crime. Subdivisions (b), (c) and (d) of this section shall not apply to cigarettes seized pursuant to this subdivision.

N.Y. Tax Law § 1846 (2002).

9. *Section 481*, subdiv. 1(c) provides as follows:

> In addition to any other penalties that may be imposed by law, the commissioner may impose a civil penalty not to exceed five thousand dollars against any tobacco product manufacturer or cigarette tax agent who violates the provisions of section four hundred eighty-b of this article, including but not limited to the filing of a false certification, and may seek to suspend or cancel any license which has been issued to such person pursuant to this chapter.

N.Y. Tax Law § 481, subdiv. 1(c) (2002).

b) *The Complaint and Proceedings in the District Court*

Appellants describe themselves as importers of tobacco products. Prior to enactment of the Contraband Statutes, appellants purchased cigarettes from foreign manufacturers and resold them with the necessary tax stamp to wholesalers and retailers in New York. However, the foreign manufacturers were neither PMs under the MSA nor making escrow payments under the Escrow Statute, and, therefore, were among the group described above whose continued sales caused the Contraband Statutes to be enacted. Because of the Contraband Statutes, cigarettes purchased by appellants from these manufacturers would be without the certification and tax stamp required for resale and would be subject to seizure and forfeiture.

Appellants therefore sought to enjoin enforcement of the Contraband Statutes on behalf of "all firms throughout the United States which purchase cigarettes made by manufacturers that do not make MSA settlement payments and do not make escrow payments pursuant to the New York State Escrow Statute, and which in turn resell such cigarettes to the wholesalers that have New York tax stamp licenses and resell such cigarettes in New York State."[10] Compl. ¶ 35, at 17. In effect, therefore, appellants are seeking to sell cigarettes in New York outside the scheme created by the MSA and enforced by the Contraband Statutes.

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10. The complaint does not specify whether appellants are themselves licensed New York State tax stamp agents. Because appellants are bringing suit only on behalf of that class of firms who resell cigarettes to "[wholesalers] having New York cigarette tax stamp licenses," Compl. ¶ 1, at 2, we consider appellants solely as "importers" and not as "wholesalers," or licensed New York State tax stamp agents.

Appendix

Appellants' complaint asserts the following claims:

(i) The Contraband Statutes interfere with interstate commerce in order to protect the payments owed to New York State under the MSA. This constitutes "favoritism, discrimination and economic protectionism" and is thus a *per se* violation of the Commerce Clause. Compl. ¶ 42, at 19.

(ii) By implementing the "output cartel" created under the MSA and the Escrow Statute, the Contraband Statutes conflict with the Sherman Act, *15 U.S.C. § 1*, and are therefore preempted. Compl. ¶ ¶ 2, 46, at 3, 19-20.

(iii) The selective enforcement of the Contraband Statutes against firms like appellants but not against wholesalers and importers on Native American Reservations situated within the State of New York, violates the Commerce and Equal Protection Clauses. Compl. ¶ ¶ 42, 49, at 19, 20.

After filing their complaint, appellants moved for a temporary order enjoining appellees from enforcing the Contraband Statutes. Appellees, in turn, moved to dismiss appellants' complaint for failure to state a claim under *Fed.R.Civ.P. 12(b)(1)* and *12(b)(6)*. After the parties filed memoranda of law and argued, the district court dismissed the complaint under *Rule 12(b)(6)*. This appeal followed.

Appendix

DISCUSSION

We review *de novo* a district court's dismissal of a complaint for failure to state a claim under *Fed.R.Civ.P. 12(b)(6). Leeds v. Meltz, 85 F.3d 51, 53 (2d Cir.1996).* We accept as true the material facts alleged in the complaint and draw all reasonable inferences in plaintiffs' favor. *Hernandez v. Coughlin, 18 F.3d 133, 136 (2d Cir.1994).* A complaint cannot be dismissed for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson, 355 U.S. 41, 45-46 (1957).*

a) *Dormant Commerce Clause Claim*

The Commerce Clause provides that "Congress shall have Power . . . [t]o regulate Commerce with foreign Nations and among the several States. . . ." *U.S. Const. art. I, § 8, cl. 3.* Under the so-called "dormant" Commerce Clause doctrine, a state's power to take actions impacting interstate commerce is limited. *See Hughes v. Oklahoma, 441 U.S. 322, 326 (1979); Automated Salvage Transp., Inc. v. Wheelabrator Envtl. Svs., Inc., 155 F.3d 59, 74 (2d Cir.1998).*

A state statute may violate the dormant Commerce Clause in several ways. First, a statute that clearly discriminates against interstate commerce in favor of intrastate commerce is "virtually invalid *per se*," *Nat'l Elec. Mfrs. Ass'n v. Sorrell, 272 F.3d 104, 108 (2d Cir.2001); see also Wyoming v. Oklahoma, 502 U.S. 437, 454-55 (1992)* (noting that when a statute clearly discriminates against interstate commerce, it will be struck down as *per se* invalid), and can survive only if the discrimination is

"demonstrably justified by a valid factor unrelated to economic protectionism," *id. at 454*. Second, if the statute does not discriminate against interstate commerce, it will nevertheless be invalidated under the "*Pike* balancing test" if it "imposes a burden on interstate commerce incommensurate with the local benefits secured." *Nat'l Elec. Mfrs., 272 F.3d at 108* (citing *Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)*). Third, a statute will be invalid *per se* if it has the practical effect of "extraterritorial" control of commerce occurring entirely outside the boundaries of the state in question. *See Healy v. The Beer Inst., 491 U.S. 324, 336 (1989)*.[11]

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11. While an allegation of such a wholly "extraterritorial" effect has been analyzed by the Second Circuit as a form of "disproportionate [ ] burden" on interstate commerce under the *Pike* balancing test, *see Nat'l Elec. Mfrs., 272 F.3d at 109-10* (treating "control of commerce that occurs wholly beyond the state's borders" as a "disparate" burden triggering *Pike* balancing analysis), it may also be analyzed independently—i.e., without reference to clear discrimination or disparate burdens—as a question of regulatory jurisdiction rather than one of regulatory discrimination. *See Healy, 491 U.S. at 336* (considering a dormant Commerce Clause challenge to the extraterritorial effect of a state statute without reference to *Pike*); *Edgar v. MITE Corp ., 457 U.S. 624, 643 (1982)* (plurality opinion) ("The limits on a State's power to enact substantive legislation are similar to the limits on the jurisdiction of state courts. In either case, 'any attempt "directly" to assert extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power.' " (quoting *Shaffer v. Heitner, 433 U.S. 186, 197 (1977)*)); *Automated Salvage Transp., 155 F.3d at 77-78* (noting that "[t]he Commerce Clause 'precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, *whether or not the commerce has effects within the State.*' " (quoting *Edgar v. MITE*

(Cont'd)

Even assuming that appellants raised each of these theories in the district court and on appeal and that they are properly before us,[12] none constitutes a valid claim under any version of the dormant Commerce Clause doctrine.

(Cont'd)

Corp., 457 U.S. at 642-43 (plurality opinion)) (emphasis added)); *see also Pharm. Research & Mfrs. of Am. v. Concannon, 249 F.3d 66, 79 (1st Cir.2001), aff'd, 123 S.Ct. 1855, 1870-71 (2003)* (considering extraterritorial effect as an independent, *per se* ground for a statute's invalidation under the dormant Commerce Clause); *Cotto Waxo Co. v. Williams, 46 F.3d 790, 793 (8th Cir.1995)* (same).

12. Appellants' complaint arguably asserts only the first, "clear discrimination" form of dormant Commerce Clause violation, *see* Compl. ¶ 42, at 18-19 ("[The Contraband Statutes] constitute[ ] a direct interference with interstate commerce. . . . Such favoritism, discrimination and economic protectionism *per se* violates the Commerce Clause."). The district court held the Contraband Statutes not to be discriminatory and went on to hold that even under the second, "*Pike* balancing test" analysis any burden incidentally imposed by the Contraband Statutes was outweighed by the local benefits secured. Appellants' brief on appeal reiterates the claim of a "clear discrimination" form of Commerce Clause violation, *see, e.g.*, Appellants' Br. at 19 ("The Contraband Statute constitutes a virtually *per se* violation of the dormant Commerce Clause."); *id.* at 23 ("[T]he protectionist objective is facially apparent"), but does not propose that we engage in a *Pike* "incidental burdens" analysis. In their reply brief, appellants advance for the first time a claim of the third, "extraterritorial" form of Commerce Clause violation described above. *See* Appellants' Reply Br. at 7 (citing *Healy, 491 U.S. 324).*

Appendix

1. *Analysis Under the "Clear Discrimination" Standard and "Pike Balancing Test"*

A state statute violates the "clear discrimination" standard when it constitutes "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93, 99 (1994)*; *see also West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 192 (1994)* ("[T]he [dormant] Commerce Clause prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." (internal citation and quotation marks omitted)).

In contrast, under the *Pike* balancing test, appellants must show that a statute enacted for a legitimate public purpose, although apparently evenhanded, actually imposes " 'burdens on interstate commerce that exceed the burdens on intrastate commerce,' " *Automated Salvage Transp., 155 F.3d at 75* (quoting *Gary D. Peake Excavating Inc. v. Town Bd. of Hancock, 93 F.3d 68, 75 (2d Cir.1996)*), and that those excess burdens on interstate commerce are "clearly excessive in relation to the putative local benefits," *Pike, 397 U.S. at 142*. "[T]he statute, at a minimum, must impose a burden on interstate commerce that is qualitatively or quantitatively different from that imposed on intrastate commerce." *Nat'l Elec. Mfrs., 272 F.3d at 109*. Under the *Pike* test, "if no such unequal burden be shown, a reviewing court need not proceed further." *Id.*

The bottom line is therefore that, under either the "clear discrimination" or the "*Pike*" forms of analysis, "the minimum showing required . . . is that [the state statute] have a disparate

impact on interstate commerce." *Automated Salvage Trans .*, *155 F.3d at 75*. Because the Contraband Statutes have no such disparate impact, either facially or in incidental effect, appellants' claim fails.

Appellants cannot and do not identify any in-state commercial interest that is favored, directly or indirectly, by the Contraband Statutes at the expense of out-of-state competitors. Appellants concede that "virtually all cigarettes sold at retail in New York are purchased out of state." Appellants' Reply Br. at 6. Moreover, the Contraband Statutes apply equally to the products of in- state and out-of-state manufacturers, and to products sold by and to in-state and out-of-state wholesalers, tax agents, and importers. Any " 'incidental' burdens," *Minn. v. Clover Leaf Creamery Co., 449 U.S. 456, 471 (1981)*, on products originating out-of-state—i.e., the so-called "[e]mbargoing" of the cigarettes of NPMs purchased by appellants, Appellants' Br. at 5—is a result of their failure to comply with the Escrow and Contraband Statutes, a burden that is no greater for out-of-state economic interests than for in-state ones.

To remedy this gap in their argument, appellants offer several novel theories. First, they propose that New York State itself is the "local" interest benefitted by the Contraband Statutes and that the goal of ensuring New York's receipt of the maximum revenue under the MSA constitutes a facially protectionist objective. However, there is simply no precedent to support the proposition that a state's generation of revenues at the expense of in-state and out-of-state economic interests alike is, without more, invalidly protectionist for Commerce Clause purposes. Nor are there grounds to create such a precedent.

For dormant Commerce Clause purposes, the relevant "economic interests," both in-state and out-of-state, are parties using the stream of commerce, not those of the state itself. *See West Lynn Creamery, 512 U.S. at 202* (describing economic interests relevant to differential burden analysis as "any part of the stream of commerce—from wholesaler to retailer to consumer"); *id. at 192* (stating that the dormant Commerce Clause prohibits state regulations that "benefit in-state economic interests by burdening out-of-state *competitors*" (emphasis added)). Were the Contraband Statutes directed solely at out-of-state economic interests, *see Guy v. Baltimore, 100 U.S. 434, 443 (1880)* (invalidating a Maryland wharfage fee regulation that imposed fees only on cargo not produced in Maryland), or in-state economic interests exempted from the Contraband Statutes' requirements, *see Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 273 (1984)* (invalidating a Hawaii statute that favored local producers by granting a tax exemption on certain liquors produced in Hawaii), or the MSA revenues used to subsidize local economic interests in competition with out-of-state economic interests subjected to the Contraband Statutes, *see West Lynn Creamery, 512 U.S. at 194-95* (invalidating a Massachusetts statutory scheme that imposed a uniform tax on milk sales and then used the proceeds of that tax to subsidize Massachusetts milk producers), appellants might be able to state a valid claim. However, the Contraband Statutes do none of these things.

Second, appellants propose that the PMs—although located out-of-state—are a "local" interest benefitted by the Contraband Statutes, and that the goal of protecting their New York market share constitutes a facially protectionist objective. Appellants' Br. at 30. Appellants rely upon the following passage— that does

not say what they claim—from the Supreme Court's opinion in *Bacchus Imports* to support this odd contention:

> The State does not seriously defend the Hawaii Supreme Court's conclusion that because there was no discrimination between in-state and out-of-state *taxpayers* there was no Commerce Clause violation. Our cases make clear that discrimination between in-state and out-of-state goods is as offensive to the Commerce Clause as discrimination between in-state and out-of-state taxpayers.

Bacchus Imports, 468 U.S. at 268 n. 8 (emphasis in original). In fact, the quoted passage stands only for the proposition that disparate treatment of in-state and out-of-state manufacturers (i.e., "goods") is just as much a violation of the Commerce Clause as disparate treatment of in-state and out-of-state consumers (i.e., "taxpayers"). To be prohibited, a statute still must favor an in-state commercial interest over a corresponding out-of-state commercial interest, an element absent in the present matter. *See Or. Waste Sys., Inc., 511 U.S. at 100* (invalidating Oregon statute that favored shippers of "Oregon waste" over shippers of waste from "other States"); *West Lynn Creamery, 512 U.S. at 192* (requiring benefit to "in-state economic interests" and burden to "out-of-state" interests); *United Haulers Ass'n v. Oneida- Herkimer Solid Waste Mgmt. Auth., 261 F.3d 245, 262 (2d Cir.2001)* (upholding statute where burden imposed "does not fall more heavily on out-of-state concerns than on local ones").

Thus, the Contraband Statutes are not "clearly discriminatory," and, under the *Pike* balancing test, do not impose "unequal burdens" on interstate and intrastate commerce. As such, we "need not proceed further." *Nat'l Elec. Mfrs., 272 F.3d at 109.*

2. *Extraterritoriality Analysis*

In their reply brief, appellants rely upon a line of Supreme Court price- regulation cases to argue that the Contraband Statutes violate the dormant Commerce Clause by regulating commerce occurring wholly outside the borders of New York. *See* Appellants' Rep. Br. at 7 (citing *Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 521 (1935)*; *Healy, 491 U.S. at 336; Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 583-84 (1986)*). Even assuming that appellants have properly preserved this argument below and raised it on appeal, *see* Note 12, *supra*, it is without merit.

As noted, a state statute will be invalid *per se* under the Commerce Clause if it has the practical effect of controlling commerce occurring wholly outside that State's borders. *Healy, 491 U.S. at 332*. In *Healy*, the Supreme Court described in detail how to assess a statute's constitutionality under the "extraterritoriality" branch of dormant Commerce Clause analysis as follows:

> First, the Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State, and, specifically, a State may not adopt legislation that has the practical effect of establishing a scale of prices for use in other states. Second, a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was

> intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State. Third, the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation. Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State.

Id. at 336-37 (internal quotation marks, citations and footnotes omitted).[13]

Appellants claim that the "artificially high prices" fostered by the Contraband Statutes "inflate[ ]" the prices charged by

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13. In this context, little danger of "inconsistent legislation" exists. In fact, a universal and practically uniform national system of payments by tobacco companies to states has been created. As noted, all of the Settling States have enacted the form Escrow Statute, *see* Compl. ¶ 19, at 10, and 24 have passed Contraband Statutes, *see* Appellants' Rule 28(j) letter. Furthermore, each of the four states that did not join the MSA— Florida, Minnesota, Mississippi and Texas—settled individually with the major tobacco companies. *See State v. Philip Morris, 179 Misc.2d at 439- 40 n. 3.* These individual settlements were similar to the MSA; for example, in approving New York's participation in the MSA, the New York County Supreme Court stated that "[t]he MSA for New York contains every single public health provision found in the Minnesota settlement." *Id. at 444.*

cigarette manufacturers to purchasers in sales transactions that occur wholly outside the State of New York. Appellants' Reply Br. at 6. Thus, appellants argue, the Contraband Statutes are regulating out-of-state commerce in the sense that, in an out-of-state transaction, "[a] purchaser of . . . product bought for resale at retail in New York either pays the price set by the Cartel or forfeits the right to ship cigarettes for sale at retail into the State of New York." *Id.* Appellants argue that this extraterritorial effect renders the Contraband Statutes *per se* invalid under the dormant Commerce Clause. *Id.* at 7.

Even assuming for present purposes that appellants' characterization of the Contraband Statutes' effect is accurate, the "practical effect" of the Contraband Statutes on extraterritorial commerce does not rise to the level of a constitutionally impermissible act. The effect does not constitute the "regulati[on of] commerce," *Healy*, *491 U.S. at 332*, "control[of] commerce," *id. at 336*, "projection of one state regulatory regime into the jurisdiction of another State," *id. at 337*, or "application of a state statute to [extraterritorial] commerce," *id. at 336*, necessary to render a state statute invalid.

The extraterritorial effect described by appellants amounts to no more than the upstream pricing impact of a state regulation. Because cigarettes sold at retail must have been produced only by manufacturers in certified compliance with New York's Escrow Statute, importers such as appellants must buy more expensive, "certified" cigarettes (in their out-of-state transactions) if they wish to sell to New York retailers. However, a similar pricing impact might result from any state regulation of a product, and "[t]he mere fact that state action may have repercussions beyond state lines is of no judicial significance so long as the

action is not within that domain which the Constitution forbids." *Osborn v. Ozlin*, *310 U.S. 53, 62 (1940)*; *see also Healy*, *491 U.S. at 345* (Scalia, J., concurring in part and concurring in the judgment) (noting that "innumerable valid state laws affect pricing decisions in other States," and cautioning against allowing Commerce Clause jurisprudence to "degenerate into disputes over degree of economic effect"). While the out-of-state wholesale prices of cigarettes may be affected by the Contraband Statutes, therefore, out-of-state actors such as appellants remain free to conduct commerce on their own terms, without either scrutiny or control by New York State.

By contrast, in the Supreme Court cases relied upon by appellants, *Seelig*,[14] *Brown-Forman*,[15] and *Healy*,[16] the Court

14. In *Seelig*, the Supreme Court struck down a New York statute that (a) established in-state minimum wholesale milk prices, and (b) banned the resale in New York of milk purchased out-of-state at wholesale prices below in-state minimums. *Seelig*, *294 U.S. at 519*. The Court found that the statute's effect was to set minimum out-of-state wholesale milk prices, stating:

> It is one thing for a state to exact adherence by an importer to fitting standards of sanitation before the products of the farm or factory may be sold in its markets. It is a very different thing to establish a wage scale or a scale of prices for use in other states, and to bar the sale of the products, whether in the original packages or in others, unless the scale has been observed.

Id. at 528.

15. In *Brown-Forman*, the Supreme Court struck down a New York statute that required liquor distillers to certify that their in-state prices were no higher than the lowest price at which the

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struck down state statutes that went a step further, controlling in-state and out-of- state pricing of goods going into the state. These statutes did so by making specific reference to the terms of such pricing—terms which burdened out-of- state actors more than in-state actors—and attaching in-state consequences where the pricing terms violated the statutes. Unlike the statutes at issue in *Seelig*, *Brown-Forman*, and *Healy*, the Contraband Statutes impose no such out- of-state burden and therefore cannot be said either to regulate prices or otherwise to control the terms of out-of-state transactions.

Finally, appellants have not alleged that the Contraband Statutes are inconsistent with the legitimate regulatory regimes of other states, *see Healy*, *491 U.S. at 336-37*, that the Contraband Statutes force out-of-state merchants to seek

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same product would be sold out-of-state during the month. *Brown-Forman*, *476 U.S. at 575-76*. The Court noted that, under the statute, "[o]nce a distiller has posted prices in New York, it is not free to change its prices elsewhere in the United States during the relevant month. Forcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce." *Id. at 582* (footnote omitted).

16. In *Healy*, the Supreme Court struck down a Connecticut statute that required out-of-state beer importers to certify that the prices at which the products were sold to Connecticut wholesalers were no higher than prices at which those same products were sold in bordering states. *Healy*, *491 U.S. at 326*. The Court held the statute to be unconstitutional because it had the effect of controlling prices in neighboring states, thereby interfering with those states' regulatory schemes and because it discriminated against those brewers and shippers of beer who were engaged in interstate commerce. *Id. at 337-40*.

New York regulatory approval before undertaking an out-of-state transaction, *see id. at 337*, or that any sort of interstate regulatory gridlock would occur if "many or every" state adopted similar legislation, *see id. at 336, 339-40.* In short, none of the indicia of an impermissible extraterritorial regulation are present.

b) *Sherman Act Claim*

Appellants' complaint alleges that the Contraband Statutes are "an implementation illegal *per se* under *§ 1* of the Sherman Act of an output cartel, [are] in direct conflict with that law and [are], accordingly, preempted by that Act." Compl. ¶ 2, at 3. The district court dismissed this claim on the sole ground that the Contraband Statutes are "immune from antitrust prosecution, because they represent a unilateral state action, not prohibited under the Sherman Act." *Freedom Holdings, Inc. v. Spitzer*, No. 02 CIV 2929, tr. at 45 (S.D.N.Y. May 14, 2002) (oral findings and conclusions) (citing *Parker, 317 U.S. 341).* The court further noted that, in its view, "New York was not seeking to create any benefit to the cigarette manufacturing companies. . . . New York was dealing, as [were] the other states, in a very important local health interest. It enacted legislation that it considered appropriate to remedy these interests. That's the very thing that *Parker v. Brown* immunizes." *Id.* at 49.

1. *Preemption Analysis*

The Sherman Act embodies a federal policy prohibiting anticompetitive conduct by private firms. Under the Supremacy Clause, of course, the power of states to adopt policies that conflict with federal law is limited. In the context of the Sherman Act, the use of the Supremacy Clause to preempt a state law

that limits competition among private firms is complicated by the fact that state police powers and regulatory authority have traditionally been thought to extend legitimately to a range of anticompetitive schemes. No one seriously argues, therefore, that the Sherman Act was intended to preempt all such regulation. On the other hand, "[t]he national policy in favor of competition cannot be thwarted by casting . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Cal. Reg'l Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 106 (1980)*. Viewing state regulation on a spectrum, at one end is state utility regulation, which in its usual form combines a state-protected monopoly with rate regulation and is not subject to preemption. *See Bedell, 263 F.3d at 255*. At the other end is a state law that purports to legalize price-fixing by private firms for no stated purpose other than protecting the private price-fixers from competition. Such a law is subject to preemption. *See Parker, 317 U.S. at 351*. Whether state statutory schemes on this spectrum are preempted depends on both the state policy goals and the regulatory means applied. We defer discussion of the legal ramifications of particular goals and means to part (b)(3) of this section of our opinion.

Whether a state statute that restrains competition among private firms is preempted by the Sherman Act is determined by a two-step analysis. The plaintiff must first show that the scheme of market control created by the statute would constitute a *per se* violation of the Sherman Act if brought about by an agreement among private parties. A statute will be preempted by the Sherman Act only if it "mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute."

Fisher v. Berkeley, *475 U.S. 260, 265 (1986)* (quoting *Rice v. Norman Williams Co.*, *458 U.S. 654, 661 (1982)*); *Battipaglia v. N.Y. State Liquor Auth.*, *745 F.2d 166, 174 (2d Cir.1984)* (quoting *Rice*, *458 U.S. at 661)*); *see also 324 Liquor Corp. v. Duffy*, *479 U.S. 335, 341 (1987)* (describing the "threshold question" as whether the state statute is inconsistent with the antitrust laws); *Midcal*, *445 U.S. at 102 (1980)* (same). For a statute to be preempted, the conduct contemplated by the statute must be "in all cases a *per se* violation" of the federal antitrust laws. *Battipaglia*, *745 F.2d at 174* (quoting *Rice*, *458 U.S. at 661)*.

Even if a *per se* violation is shown, the alleged anticompetitive scheme may still be immunized under the *Parker* state action doctrine only where it regulates commerce in furtherance of legitimate state policy goals and limits unnecessary anticompetitive effects. A statute that permits or compels private parties to engage in *per se* violations of the federal antitrust laws will be saved from preemption if: (i) the restraint in question is "clearly articulated and affirmatively expressed as state policy," and (ii) the policy is "actively supervised" by the state itself. *Midcal*, *445 U.S. at 105* (quoting *City of Lafayette v. La. Power & Light Co.*, *435 U.S. 389, 410 (1978)*).

We address these analytic steps in turn.

2. *Per Se Violation*

As noted, the first question is whether the scheme alleged to have been created by the Contraband Statutes would constitute a *per se* violation of federal antitrust law if brought about by an agreement among private parties.

Appendix

(i) *Unilateral Act of State*

Appellees argue that appellants cannot meet this test because a *per se* violation requires, in the language of the Sherman Act itself, a private "contract, combination, or conspiracy" to restrain trade and that what is challenged here is a "unilateral act" of government rather than a "contract, combination, or conspiracy." Appellees' Br. at 39. This argument ignores both applicable Supreme Court caselaw and the relationship of the Contraband Statutes to the MSA as alleged in the complaint.

First, the unilateral act of a state government protecting private parties from competition can be preempted by the Sherman Act. Where the anticompetitive effects of a state statute obviate the need for private parties to act on their own to create an anticompetitive scheme, the statute may be attacked as a "hybrid" restraint on trade. In *324 Liquor*, the Supreme Court held:

> Where "private actors are granted a degree of private regulatory power [by a state] the regulatory scheme may be attacked under *§ 1*" as a "hybrid" restraint. . . . [T]he federal antitrust laws pre-empt state laws authorizing or compelling private parties to engage in anticompetitive behavior.

324 Liquor, 479 U.S. at 345-46 n. 8 (some internal quotation marks and ellipses omitted) (quoting *Fisher v. Berkeley, 475 U.S. 260, 268 (1986)* (quoting *Rice v. Norman Williams Co., 458 U.S. 654, 666, n. 1 (1982)* (Stevens, J., concurring in the judgment))). In rejecting the position taken by appellees, namely that a private "contract, combination, or conspiracy" must be

shown to support a Sherman Act preemption claim,[17] the Court stated that the federal antitrust laws may preempt state laws that authorize or compel private parties to engage in anticompetitive behavior. *See id.*

Second, *324 Liquor* itself invalidated a statute that was far more "unilateral" than the scheme alleged here. *324 Liquor* involved a New York law that required liquor retailers to charge 112% of wholesalers' posted bottle prices where that posting of prices was also required by New York law. *479 U.S. at 337-39*. The only private acts involved were the individual determinations of each wholesaler as to what bottle price to post. *Id. at 337-40.*

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17. Appellees rely upon our decision in *Battipaglia v. New York State Liquor Authority, 745 F.2d 166 (2d Cir.1984)*, which stated that in that case "plaintiffs have been faced from the outset with the difficulty that the challenged provisions of the [state statute] do not compel any agreement," *id. at 170*, to support their argument that a private "contract, combination, or conspiracy" must be shown for Sherman Act preemption to occur. However, *Battipaglia* actually noted diverging lines of authority on the question of whether a showing of a private agreement is necessary for preemption, and ultimately declined to "resolve that difficult question." *Id.* at 173. The majority did not reach the question because it held that the anticompetitive acts at issue in that case—the exchange of price information—would constitute only a rule-of-reason restraint rather than a *per se* restraint. *Id.* at 174-75 (citing *Rice v. Norman Williams Co., 458 U.S. 654, 659-62 (1982)*). In any event, since our decision in *Battipaglia*, the Supreme Court has made it clear that an actual "contract, combination or conspiracy" need not be shown for a state statute to be preempted by the Sherman Act. *324 Liquor, 479 U.S. at 345-46 n. 8.*

By sharp contrast, the Contraband Statutes allegedly enforce an express market-sharing agreement among private tobacco manufacturers, the MSA. As alleged in the complaint, the Contraband Statutes are the result of the incentives created by the MSA for the States, here New York, to pass legislation that would prevent NPM Adjustments caused by price competition from diminishing revenue to the State.[18] The MSA was an agreement involving the State of New York, but it also was by any definition a "contract" that the four major tobacco manufacturers jointly negotiated among themselves (and for which they unsuccessfully sought an antitrust exemption from the Congress[19]) and with the states, and that other smaller

18. Appellees claim that appellants, while challenging the Contraband Statutes, have conceded the validity of the MSA and the Escrow Statute under the Sherman Act. *See* Appellees' Br. at 38. No such concession has been made. Indeed, it is clearly alleged that the Contraband Statutes are anticompetitive precisely because they implement the cartel established by the MSA. Appellants do not challenge the MSA directly because it is the Contraband Statutes, not the MSA standing alone, that injures them.

19. The proposed exemption, part of a bill sponsored by Senator McCain and introduced on November 7, 1997, read as follows: "Antitrust Exemptions.-The provisions of the Sherman Act (*15 U.S.C. 1 et seq.*), the Clayton Act (*29 U.S.C. 52 et seq.*), and any other federal or state antitrust laws shall not apply to an association or organization to which subsection (B) applies." Universal Tobacco Settlement Act, S. 1415, 105th Cong. § 155(D) (1997). Subsection (B) applied to tobacco industry trade organizations or other associations that met certain requirements for "independent" boards and bylaws. *Id.* at § 155(B). According to testimony at a Senate hearing, a broader antitrust immunity provision was also considered, which read as follows: "In order to achieve

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manufacturers subsequently joined. The parties to the MSA are alleged in the complaint to constitute horizontal competitors originally controlling 99% of the market. Even if a "contract" among private parties is required in the first step of preemption analysis, therefore, it exists in the present matter.[20]

(ii) *The Allegations of the Complaint*

We turn then to the question whether the behavior alleged to be authorized or compelled by the Contraband Statutes (i.e., enforcement of the alleged output cartel) would be a *per se* Sherman Act violation if done by private agreement.

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the goals of this agreement and the Act relating to tobacco use by children and adolescents, the tobacco product manufacturers may, notwithstanding the provisions of the Sherman Act, the Clayton Act, or any other federal or state antitrust law, jointly confer, coordinate, or act in concert, for this limited purpose." *Tobacco Settlement: Hearing Before the Senate Comm. on Commerce, Sci. and Transp.*, 105th Cong. (1998) (LEXIS, National Narrowcast Network) (statement of Robert Pitofsky, Chairman, Federal Trade Commission). This provision, however, does not appear in any version of the legislation available on lexis.com.

20. Appellees suggest in a footnote that the state action immunity turns upon whether the defendants in the action are private parties or state officials. *See* Appellees' Br. at 42-43 n. 13. We disagree. If a state statute is preempted, state officials may be prevented from enforcing it. In fact, in *324 Liquor*, the members of the New York State Liquor Authority were parties to the action and were prevented from enforcing the law challenged there. The only distinction between *324 Liquor* and the present case is that, in *324 Liquor*, the state officials initiated the action. *See* Brief for Appellants, *324 Liquor Corp. v. Duffy*, *479 U.S. 335 (1987)* (No. 84-2022).

Appendix

See generally 1 Philip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 217b2, at 306-07 (2d ed.2000).

Horizontal agreements among competing sellers to fix prices or restrict output are, absent more, *per se* violations of *Section 1* of the Sherman Act. *See Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 100 (1984)* ("Horizontal price fixing and output limitation are ordinarily condemned as a matter of law under an 'illegal *per se*' approach because the probability that these practices are anticompetitive is so high; a *per se* rule is applied when 'the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output.' " (quoting *Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 19- 20 (1979)*)); *Bedell, 263 F.3d at 247* ("An agreement which has the purpose and effect of reducing output is illegal under *§ 1* of the Sherman Act."); *see also Gen. Leaseways, Inc. v. Nat'l Truck Leasing Ass'n, 744 F.2d 588, 594-95 (7th Cir.1984)* ("[W]ith exceptions not relevant here, raising price, reducing output, and dividing markets have the same anticompetitive effects."), *quoted in Cal. Dental Ass'n v. FTC, 526 U.S. 756, 777 (1999)*; *United States v. Andreas, 39 F.Supp.2d 1048, 1060 (N.D.Ill.1998)* ("Direct price agreements and sales volume are two sides to the same price-fixing coin.").

Appellants have alleged in detail that the MSA/Contraband Statutes scheme involves both market division and price-fixing. As alleged, the MSA was agreed to by horizontal competitors who originally controlled 99% of the market for cigarettes and created substantial disincentives for any PM to attempt to increase its market share through price competition. These disincentives are found in the MSA's various provisions requiring

that increased payment obligations accompany increased market share. Because market-share increases among manufacturers are substantially "penalized," *see* note 5, *supra*, Compl. ¶ 17, at 9, appellants allege that the OPMs, as market share leaders, have the discretion to increase prices—at least until higher prices would reduce profits—assured that competitors will follow their price lead so as to avoid picking up a new market share, profits from which will be offset by required payments to the Settling States. As the Third Circuit observed in *Bedell*:

> [I]t is clear the [MSA] empowers the tobacco companies to make anticompetitive decisions with no regulatory oversight by the States. Specifically, the defendants are free to fix and raise prices, allegedly without fear of competition.

Bedell, 263 F.3d at 260; *see also id. at 246* (citing plaintiffs' allegations that the four majors could have funded the settlement agreement with a $0.19 increase in price, but that the majors immediately raised prices by $0.45 per pack, and subsequently by another $0.31 per pack). The scheme as alleged also involves market division and price-fixing enforced against NPMs by wholesalers refusing to deal with them because of the provisions of the Contraband Statutes. In short, plaintiffs allege that the combination of the MSA, the Escrow Statutes, and the Contraband Statutes, allows OPMs to set supracompetitive prices that effectively cause other manufacturers either to charge similar prices or to cease selling. Compl. ¶ ¶ 2, 13, 17, 20, at 2-11. NPMs are forced to charge these prices to cover the costs imposed by the Escrow and Contraband Statutes or go out of business in New York.

The alleged arrangement, even without the protection of the Contraband Statutes as enforced by wholesalers, would be a *per se* violation because it is a naked restraint on competition, albeit one subject to erosion by NPMs. *See* 11 Herbert Hovenkamp, *Antitrust Law*, ¶ 1910, at 252-65 (1998) (*per se* illegality for "naked" restraints.) With the Contraband Statutes in force, the scheme as alleged threatens to become a permanent, nationwide cartel, *see* note 13, *supra*.

Had the executives of the major tobacco companies entered into such an arrangement without the involvement of the States and their attorneys general, those executives would long ago have had depressing conversations with their attorneys about the United States Sentencing Guidelines. *See U.S.S.G. § 2R1.1* (Antitrust Offenses). We therefore hold that appellants have sufficiently alleged a *per se* violation of the Sherman Act.

3. *State Action Immunity*

We now turn to the question of whether the statute is saved from preemption under *Parker v. Brown*. As noted, *Parker* preserves the ability of states to promulgate anticompetitive regulations in furtherance of legitimate state policy goals. *See Parker, 317 U.S. at 350-51* (declining to attribute to Congress's enactment of the Sherman Act "an unexpressed purpose to nullify a state's control over its officers and agents"); 1 Areeda & Hovenkamp, *supra*, ¶ 217d, at 316-17. A common example is state protection and regulation of monopolies that provide services such as electric power. *See Bedell, 263 F.3d at 255*. However, as *Parker* noted, a state cannot simply "give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."

Parker, 317 U.S. at 351. Rather, as *Midcal* made explicit, the state must substitute its own policy objectives and regulatory oversight for the federal antitrust policy and enforcement mechanisms displaced by the state legislation. That is, if a state statute mandates or authorizes *per se* violations of the antitrust laws, it will be saved from preemption only if (i) the restraint in question is "clearly articulated and affirmatively expressed as state policy," and (ii) the policy is "actively supervised" by the *State itself. Midcal, 445 U.S. at 105* (quoting *City of Lafayette, 435 U.S. at 410).*

(i) *Clear Articulation and Affirmative Expression*

We turn then to the first prong of the *Midcal* analysis, whether the anticompetitive restraint alleged—the output cartel—has been "clearly articulated and affirmatively expressed as state policy." We are somewhat disadvantaged in discussing this question because the district court never addressed it and the parties' briefs have not joined issue on it. Appellants found no need to dwell on the issue because the second *Midcal* requirement— state oversight of the pricing conduct of the tobacco firms protected by the Contraband Statutes—is obviously not met. Appellees in turn have been content to rest their case essentially on the "unilateral act" argument rejected above and on conclusory references to claimed health care benefits resulting from the MSA.

(A) *Express Adoption of an Anticompetitive Scheme*

One purpose of the first *Midcal* prong is to ensure that state action immunity is afforded only to actions taken by the state. Most assuredly, agreement to the MSA by the New York

Attorney General,[21] approval of it by a New York court, and passage of the Contraband Statutes were express acts of the State of New York. This purpose of the first *Midcal* prong is therefore satisfied. *See Cine 42d St. Theater Corp. v. Nederlander Org., 790 F.2d 1032, 1042 (2d Cir.1986).*

(B) *State Policy Goals*

However, there is an ancillary purpose of this *Midcal* prong, which in this case is to reveal the State's purposes in agreeing to, and enforcing, the MSA's market-share provisions. These purposes must be known to ensure that the State's policy goals

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21. Appellees have not argued that because the MSA is a settlement of a lawsuit, it somehow achieves an immunity not otherwise available. Of course, such an argument would be fruitless. First, such an argument would negate appellees' claim that the requisite contract, combination or conspiracy is lacking. *See* "Unilateral Act of State," subsection (b)(2)(i), *supra.* Second, Sherman Act violations are generally not immunized because the anticompetitive scheme is embodied in the settlement of a lawsuit. *See United States v. Singer Mfg. Co., 374 U.S. 174 (1963)* (holding that settlement agreements between the Singer Company and its Italian and Swiss competitors violated the Sherman Act); *Duplan Corp. v. Deering Milliken, Inc., 594 F.2d 979, 981 (4th Cir.1979)* (per curiam) (affirming district court's finding that settlement agreement "was the core of a scheme to stabilize and maintain production royalties ... and to monopolize the United States market."). Third, this result is not altered because a state attorney general has negotiated such an agreement. If the law were otherwise, a state attorney general would be able to do what *Midcal* and *324 Liquor* deny state legislatures by bringing a lawsuit and settling in an anticompetitive agreement. If the model of the MSA was followed, the state attorneys general might collectively establish a nationwide cartel. *See* note 13, *supra.*

are sufficient to qualify for the *Parker* immunity— simply protecting private parties from competition is not a sufficient goal, *see Parker, 317 U.S. at 351-52.* Of course, if the purposes are not of the kind that would trigger *Parker* analysis, we generally would deny the immunity on *Parker* grounds rather than on a failure to satisfy the first *Midcal* prong. Indeed, it is doubtful that a federal court would upset a state statute solely because it failed to meet the explanatory aspect of the first *Midcal* prong if it passed muster in all other respects. Nevertheless, that prong does implicate the purposes of the State, and we accordingly discuss the enunciated goals of the Contraband Statutes and MSA here.

On the record before us, the statement closest to articulating the State's interest is Governor Pataki's memorandum urging passage of the Contraband Statutes, which stated:

> The . . . Master Settlement Agreement (MSA) requires downward adjustment in payments to states if it is determined that the MSA caused the participating manufacturers to lose aggregate market share to nonparticipating manufacturers (NPM's). States can protect themselves from NPM adjustments by enacting [an Escrow Statute], and "diligently enforcing" that law. Immediate enactment of the [Contraband Statutes] would substantially bolster the State's ability to diligently enforce the [Escrow Statute] and help protect the State from future [NPM] adjustments. . . .

Appellants' Br. at 18 (quoting Governor Pataki Memorandum of Oct. 29, 2001). While this statement admits the State's interest

in the revenue from cigarette sales, it falls short of expressly stating why the market-share provisions are needed to effectuate state policy goals.

The Escrow Statute contains a "Findings and purpose" section, set out in full in the margin,[22] that notes: (i) the health

22. *Section 1399-nn* states:

Findings and purpose

1. Cigarette smoking presents serious public health concerns to the state and to the citizens of the state. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

2. Cigarette smoking also presents serious financial concerns for the state. Under certain health-care programs, the state may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

3. Under these programs, the state pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

4. It is the policy of the state that financial burdens imposed on the state by cigarette smoking be borne by

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dangers of cigarettes, (ii) the resultant health care costs to the State, (iii) the OPMs' obligation to pay substantial sums to the

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> tobacco product manufacturers rather than by the state to the extent that such manufacturers either determine to enter into a settlement with the state or are found culpable by the courts.
>
> 5. On November twenty-third, nineteen hundred ninety-eight, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the state. The master settlement agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the state (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.
>
> 6. It would be contrary to the policy of the state if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the state will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the state to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short- term profits and then becoming judgment-proof before liability may arise.

N.Y. Pub. Health Law § 1399-nn (2002).

State, (iv) the fact that these payments are "tied in part to their volume of sales," and (v) the state's policy of preventing NPMs from using their cost advantage to reap greater profits while the State bears the resultant health care costs. However, this "Findings and purpose" section articulates no more than the conceded health concerns over cigarettes, a settlement that includes a levy on every cigarette sold by the OPMs, and a need to force NPMs to pay a similar amount.

Also, appellees assert in their brief, but without elaboration, that the MSA's market-share provisions are designed "to ensure that MSA payments per cigarette remain essentially constant regardless of whether sales increase or decrease," Appellees' Br. at 11, and that the payment obligations of the MSA do nothing other than "protect the State from having to bear the costs of an inherently deadly product," *id.* at 44.

Appellee's arguments therefore equate the MSA's market-share provisions with a flat tax levied on every cigarette sold. Indeed, a flat levy would accomplish the purposes set out in the Escrow Statute and appellees' brief, without anticompetitive effects and without creating any conflict with the Sherman Act.[23]

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23. *See Antitrust Implications of the Global Tobacco Settlement: Hearing Before the Senate Comm. on the Judiciary*, 105th Cong. (1997) (LEXIS, National Narrowcast Network) (statement of Robert Pitofsky, Chairman, Federal Trade Commission) ("The arguments that I've heard as to why this kind of exemption is necessary are as follows: One, that it's important to ensure that the annual payments, that could amount to $15 billion a year in five or six years, be passed along in the form of higher prices. But one has to ask the question: Why do you need an antitrust exemption to do that? If the excise taxes go up or have gone up in the past, there are studies that show

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Appendix

A flat levy on every cigarette sold would not prevent price competition among cigarette manufacturers whereas the scheme alleged by appellants involves: (i) adjustments based on a particular manufacturer's market share as well as total volume, (ii) trebled decreases in payments under the NPM Adjustment, (iii) immunity from NPM Adjustments for Settling States that pass Escrow Statutes and "diligently enforce" them through Contraband Statutes, (iv) alleged disincentives for SPMs to increase market share, and (v) differential tax effects of the Escrow and Contraband Statutes on NPMs, all of which are alleged to constitute an output cartel in which the State shares profits. We are not second-guessing the State's choice of means to a policy goal. We are simply noting the fact that the State denies any anti-competitive effect and offers no explanation for the anti-competitive scheme that is alleged and challenged by appellants.

We note in that regard that it is questionable whether *Parker* immunity extends to a cartel arrangement supported by a state solely to allow the state to share the monopoly profits as state revenue, perhaps implied as the goal of the Contraband Statutes in Governor Pataki's statement quoted above. States may not shield private parties from competition solely to benefit those parties. The conflict with the Sherman Act is arguably not lessened

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they've been passed along to consumers. If the price of paper or tobacco went up in an industry like this, wouldn't we expect that the increased costs would be passed along to consumers? An exception of this kind would be most unusual, it could be construed to allow a kind of price fixing that I think we would not be comfortable with, and therefore I just can't see a justification along that line.").

by the fact that the private parties pay the state a share of their monopoly revenues for that protection. A state is quite able to raise revenue by taxing private parties who compete for the favor of consumers.

The failure of the State to elaborate a rationale[24]—competitive or anti-competitive—for the market-share provisions is echoed in the district court's decision and in appellees' brief. The district court, in upholding the Contraband Statutes, stated in conclusory fashion only that "New York was not seeking to create any benefit to the cigarette manufacturing companies . . . [but] was dealing . . . in a very important local health interest." *Freedom Holdings*, tr. at 49. Appellees' brief also resolutely denies any anticompetitive intent or effect and emphasizes public health benefits from the MSA, but only in conclusory terms.

A court might infer from the MSA and accompanying statutes themselves that they are thought to serve both public health and revenue enhancing purposes of the State, although the State offers no reason why it used methods suppressing competition rather than a flat tax to achieve the same result. As discussed above, it is doubtful, although we do not decide the issue, that a State may shelter private parties from the Sherman Act solely in order to share monopoly profits. Moreover, at this stage in the proceeding and given the allegations of the complaint, the goals of serving public health and enhancing revenue conflict. That is to say, the fewer cigarettes sold, the less threat to public health, but also the less revenue raised by the State, and vice versa. Also, because the MSA requires the PMs to pay a fixed fee per cigarette but leaves them free to set whatever price they choose,

24. We of course do not foreclose the State from offering a rationale for the market-share scheme in subsequent proceedings.

the resolution of the price/sales/public health conflict is left by the MSA to the PMs, whose concern for public health, or for that matter State revenues, is not self-evident.

So far as we can tell, the principal public discussion of the effect of the market-share provisions of the MSA on competition took place when the major tobacco companies unsuccessfully sought from the Congress an exemption from the Sherman Act for the MSA. *See Tobacco Settlement: Hearing Before the Senate Comm. on Commerce, Sci. and Transp.*, 105th Cong. (1998) (LEXIS, National Narrowcast Network) (statement of Robert Pitofsky, Chairman, Federal Trade Commission) (The antitrust exemption "is vague, it's open ended, and in my opinion, it's largely unprecedented. We don't give industries exemptions from the antitrust laws, if we think the competitive system will work. And it seems to me it certainly can work with respect to tobacco products. [An antitrust exemption] also could produce unfortunate consequences. One of the goals of the agreement is to raise the price of a pack of cigarettes, so as to discourage young people from smoking. This provision, as it reads here, says that the tobacco executives can get together in a room and agree on what the price of a pack of cigarettes is. It could be a price much higher than the cost of the annual payments. That seems to me not sensible. Now, the companies have come forward with a number of reasons why they say they need an antitrust exemption. They have to agree on what the payments are, if annual payments are required. Why do they have to agree? I mean, the payments will be required by law. All they have to do is obey the law.").

As noted, an ancillary function of the first *Midcal* prong is to establish the legitimate State policy underlying the decision to

displace the Sherman Act. Absent such a policy, the Contraband Statutes would contravene *Parker*'s denial of state power to "give immunity [to the tobacco companies] by authorizing them to violate [the Sherman Act], or by declaring that their action is lawful." *Parker, 317 U.S. at 351.* Until now the State has relied in conclusory fashion on the claimed benefits to public health as a showstopper rendering further analysis or discussion irrelevant. It suffices to say here that, on the allegations of this complaint, the relationship of such benefits to the restraint on competition is not obvious[25] and may even be counterproductive.[26]

25. The principal health benefit from the arrangement as alleged appears to be that cigarette sales will be reduced by the higher prices that result from the cartel arrangement. However, because cigarettes are addictive, the demand for them is relatively inelastic, at least in the short run, and the health benefits from this aspect of the MSA have a ceiling. Moreover, given the broad police powers of the state to regulate the marketing of dangerous commodities, effective public health measures other than affording tobacco manufacturers a cartel are ubiquitous and far more obvious than the complex market-share arrangements of the MSA enforced by the Contraband Statutes. For example, if limiting sales of cigarettes by higher prices is chosen as a public health measure, a flat but high tax on each cigarette sold would alone do the trick. Similarly, restrictions on marketing could be enacted.

26. Some of the Settling States may come to rely heavily on revenue from the MSA, as perhaps reflected in Governor Pataki's statement. *See also* Rick Hampson, *States Squander Chance to Help Fight Smoking*, USA Today, Mar. 11, 2003, at B1 (quoting Washington state attorney general's statement that "[t]he money in the tobacco settlement is as addictive to states as the nicotine in cigarettes is to smokers"); Gordon Fairclough and Vanessa O'Connell, *Co-Dependents: Once Tobacco Foes, States are Hooked on Settlement Cash*, Wall St. J., Apr. 2, 2003, at A1 (quoting R.J.

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Reynolds executive's statement that after the settlement, "the states make more money from each pack of cigarettes sold than anyone else"). Some Settling States may therefore have second thoughts about measures to reduce further the sale of cigarettes. In that regard, some Settling States have issued bonds that are secured by future tobacco revenue under the MSA but would become obligations of the particular States should tobacco revenues be insufficient. *See* Deborah Finestone, *Oregon Sells $428 Million Backed by Dual Security Pledge*, Bond Buyer, April 7, 2003, at 5; Christine Albano, *The Week Ahead: New York's $2.3B Tobacco Sale Seeks to Sublimate the Stain*, Bond Buyer, June 9, 2003, at 40. Further reductions in the sale of cigarettes might have very severe fiscal consequences for such States.

There are also increasing signs of alliances between the Settling States and the OPMs. For example, 37 state and territorial attorneys general appeared as *amici* on behalf of a cigarette manufacturer's motion in an Illinois state court to reduce an appellate bond that might throw the company into bankruptcy. Brief of Amici Curiae Attorneys General, *Price v. Philip Morris, Inc.*, No. 00-L-112 (3d Cir.Ill. Apr. 2003) (unpublished decision); William McQuillen, *"Progress" in Philip Morris Lawsuit: US $12 Billion in Dispute*, National Post (Bloomberg), April 12, 2003, at FP7. Finally, in the wake of that incident and at the request of their attorneys general, 16 states have passed legislation capping the size of appeal bonds that can be required of corporations. *See, e.g., Va.Code Ann. § 8.01- 676.1(J) (2003)* (effective March 10, 2000) ("If the appellee in a civil action obtains a judgment for damages other than compensatory damages, or in excess of the compensatory damages, and the appellant seeks a stay of execution of the judgment in order to obtain review in the Court of Appeals or Supreme Court, the appeal bond or irrevocable letter of credit for the portion of the damages, other than the compensatory damages, or in excess of

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(ii) *Active Supervision*

We turn now to the second *Midcal* prong, whether the alleged anticompetitive scheme is actively supervised by New York. We conclude that it is not. Neither the New York statutes, the MSA, nor any other New York law or regulation "actively supervise[s]" the pricing decisions within the allegedly- anticompetitive market structure enforced by the Contraband Statutes. Appellees' brief does not claim otherwise or even discuss the issue.

We are directed to no mechanism in the MSA or any of the related legislation whereby New York may "review[ ] the reasonableness" of the pricing decisions of tobacco manufacturers. *Midcal, 445 U.S. at 105*. Nor is there provision for New York to "monitor market conditions or engage in any 'pointed reexamination' of the program." *Id. at 106*. The PMs are therefore free to charge the profit maximizing price, the classic monopoly result.

We therefore agree with the Third Circuit in *Bedell*, which noted:

> [J]ust as the injury in *Midcal* was caused by private parties taking advantage of the state imposed market structure, the anticompetitive injury here resulted from the tobacco companies' conduct after implementation

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the compensatory damages, shall not exceed $ 25,000,000.") The bond- capping legislation in four of the Settling States is limited to corporations that are MSA PMs. *See, e.g. Nev.Rev.Stat. Ann. § 20.035(1) (2003)* (effective May 29, 2001) ("[I]f an appeal is taken of a judgment in a civil action in which [a PM] is required to give a bond in order to secure a stay of execution of the judgment during the pendency of the appeal, the amount of the bond must not exceed $ 50,000,000."). *See also* Fairclough and O'Connell, *supra.*

> of the [MSA], and not from any further positive action by the States. Even though, as defendants argue, the [MSA] created the cartel, this fact makes the case analogous to *Midcal*, not different.

263 F.3d at 258, and then concluded:

> The States . . . lack oversight or authority over the tobacco manufacturers' prices and production levels. These decisions are left entirely to the private actors. Nothing in the [MSA] or its [Escrow] Statutes gives the States authority to object if the tobacco companies raise their prices.

Bedell, 263 F.3d at 264.[27]

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27. In a replay of their argument rejected in subsection (b)(2)(i) of this section of the opinion, namely that *Parker* requires a private "contract, combination, or conspiracy" to satisfy the *per se* violation requirement and that unilateral acts of a state are immune, appellees argue that the active supervision requirement should not be applied in this case:

> Where challenged acts are those of private parties, as were the acts in *Bedell*, [the *Midcal* active supervision requirement will apply]. In contrast, acts of a State's legislature—like those that Plaintiffs have challenged here—are always immune under the state action doctrine. *Hoover v. Ronwin, 466 U.S. 558 (1984)*. . . .

Appellees' Br. at 42 n. 13. This argument is clearly contrary to the decisions in *Midcal*, 445 U.S. at 105, and *324 Liquor, 479 U.S. at 341-45*.

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Therefore, under the present allegations, New York has failed to provide for any state supervision, much less active supervision, of the pricing conduct of cigarette manufacturers under the anticompetitive market structure created by the MSA and the Contraband Statutes. "Absent such a program of supervision, there is no realistic assurance that a private party's anticompetitive conduct promotes state policy, rather than merely the party's individual interests." *Patrick v. Burget, 486 U.S. 94, 101 (1988).* That leads us to conclude that the Contraband Statutes, were the allegations of the complaint proven, would not be saved by the *Parker* state action immunity.

As the Supreme Court stated in *324 Liquor*, the essence of the allegation is that "[t]he State has displaced competition . . . without substituting an adequate system of regulation. 'The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement.' " *479 U.S. at 345* (quoting *Midcal, 445 U.S. at 106).*

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Appellees' reliance upon *Hoover v. Ronwin, 466 U.S. 558 (1984),* is misplaced. That case held an allegedly anticompetitive Arizona bar admission program immune from antitrust challenge where, although the program was largely administered by a committee of private law practitioners, the practitioners were conceded to be "state officers" in carrying out their committee functions, and the Arizona Supreme Court nevertheless "retained strict supervisory powers and ultimate full authority" over the committee's actions. *Id. at 572.* The Court did state in that case that legislative state action is "*ipso facto*" immune under federal antitrust law, *id. at 568*, but that decision was in the context of anticompetitive conduct performed entirely by state actors, without any private involvement, and therefore effectively satisfied the *Midcal* supervision requirement. *See* 1 Areeda & Hovenkamp, *supra* ¶ 227, at 492.

4. *The Noerr-Pennington Immunity*

Finally, appellees claim that the Contraband Statutes are protected under the *Noerr-Pennington* immunity. *See E. R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961)*; *United Mine Workers of Am. v. Pennington, 381 U.S. 657 (1965)*. The *Noerr-Pennington* immunity is a First Amendment-based doctrine that protects private parties from liability under the Sherman Act in connection with efforts to petition for anticompetitive legislation. *See Bedell, 263 F.3d at 250-51* (describing *Noerr-Pennington* as offering private parties immunity from antitrust liability arising from the act of petitioning or from government action which results from the petitioning). However, the immunity for advocacy cannot sensibly protect the resultant anticompetitive legislation from being held to be preempted as in conflict with the Sherman Act. Otherwise, all such legislation would be immune. *See* 1 Areeda & Hovenkamp, *supra*, ¶ 217a, at 301 ("[W]hen state law merely purports to authorize, or even compel, unsupervised private action of a kind that violates the antitrust laws, the state law is preempted by the force of federal law."). Here, appellants do not seek to impose liability on private defendants but rather seek to have the Contraband Statutes declared invalid and their enforcement enjoined.

Given *Noerr-Pennington*'s First Amendment concerns, and for obvious pragmatic reasons, the proper time at which to decide a preemption issue like the present one is not the pre-legislation advocacy stage. The end product of regulatory legislation can take many forms, some preempted, some not. Due to the indeterminate nature of the legislative process and the ambiguities inherent in political advocacy, a process that sought to prevent

advocacy of laws that might be subject to preemption would inevitably tread on advocacy of laws that are not. This does not, however, protect the ultimate legislative result from Supremacy Clause analysis. The *Noerr-Pennington* immunity, therefore, does not bar appellants' claims.

c) *Equal Protection Claim*

Appellants' selective enforcement claim is set out in part as follows:

> The defendants subject the sales of all cigarettes by importers or wholesalers to retailers within the State of New York to the terms of the [Contraband Statutes], *with the exception of sales by [wholesalers and importers]*[28] *located on Native American Reservations* situated within the State of New York.

Compl. ¶ 3, at 3. (emphasis added). Moreover, the complaint further alleges that defendants have "selectively enforce[d]" the Contraband Statutes so as to "economically favor [wholesalers and importers] on Native American Reservations situated in the State of New York," thereby "discriminating against plaintiffs and the other members of the class" in violation of the Equal Protection Clause. Compl. ¶ ¶ 44, 49, at 19, 20. Finally the

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28. Before the district court, appellants indicated that the term "retailers" should be replaced by "wholesalers and importers" for purposes of their Equal Protection claim. *See Freedom Holdings*, tr. at 51. We have therefore deemed the appellants' complaint to be altered where such alternation is appropriate.

complaint also presents the following question as a "question of law and fact" raised by its allegations:

> Does the defendants' consistent selective enforcement of the New York Contraband Statute in favor of direct buying [wholesalers and importers] on Native American Reservations situated within the State of New York, whereby the cigarettes those [wholesalers and importers] sell to any purchasers, including citizens and residents of the State of New York, [sic] constitute economic favoritism in favor of those Native American Reservation [wholesalers and importers] and discrimination against importers such as plaintiffs and the other members of the class in violation of . . . the Equal Protection Clause . . .?

Compl. ¶ 37(d), at 18.

To establish a violation of the Equal Protection Clause based on selective enforcement, a plaintiff must ordinarily show the following:

> (1) [that] the person, compared with others similarly situated, was selectively treated; and (2) that such selective treatment was based on impermissible considerations such as race, religion, intent to inhibit or punish the exercise of constitutional rights, or malicious or bad faith intent to injure a person.

Lisa's Party City, Inc. v. Town of Henrietta, 185 F.3d 12, 16 (2d Cir.1999) (internal quotation marks and citations omitted). The district court essentially held that appellants could not

establish the second element, an impermissible consideration. In that regard, it relied on *Washington v. Yakima Indian Nation, 439 U.S. at 500-01* (finding that a legislative classification singling out tribal Indians was not "suspect," because of "the unique legal status of Indian tribes under federal law," and therefore employing rational basis review), and *New York Ass'n of Convenience Stores v. Urbach, 92 N.Y.2d at 212-13* (applying rational basis review to a New York State policy of not enforcing tax laws with respect to on-reservation cigarette sales). *See Freedom Holdings*, tr. at 51.

We have concluded that we should remand this claim for two reasons. First, the basis for the district court's reliance upon *Yakima Nation* and *Urbach* is unclear. These decisions deal with the exercise and non-exercise respectively of state jurisdiction on reservation land. In their brief and reply brief, appellants have made it clear that the alleged discriminatory failure of enforcement occurs only with respect to "shipments made from . . . Reservations to New York wholesalers located outside of the Reservation." Appellants' Br. at 53; *see also* Appellants' Reply Br. at 24 ("Native American manufacturers, importers and wholesalers are free to make and sell cigarettes made by [NPMs] and ship them outside of the Reservation without being subjected to the forfeiture penalties of the Contraband Statute."). We do not therefore have the views of the district court on appellants' claim as presently framed. Because we are remanding for a second reason, we see no purpose in addressing this particular issue further on this appeal.

Second, under the rules of notice pleading, the complaint must contain allegations sufficient to alert the defendants to the nature of the claim and to allow them to defend against it.

See Conley v. Gibson, *355 U.S. 41, 47 (1957)* ("[T]he Rules require [ ] 'a short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." (quoting *Fed.R.Civ.P. 8(a)(2)* (*quoted in Swierkiewicz v. Sorema N.A.*, *534 U.S. 506, 512 (2002)*)). The present complaint fails to meet this test.

In particular the complaint fails to explain how, and at what stage of, the resale to "wholesalers located outside of the Reservation," Appellants. Br. at 53, the non-enforcement occurs. It is alleged that any off-reservation wholesaler or importer who purchases cigarettes is subject to enforcement of the Contraband Statutes. Because subsequent sales by wholesalers and importers of cigarettes purchased from wholesalers and importers on Native American reservations are subject to the Contraband Statutes, these cigarettes would presumably bear the same tax and Escrow Statute certification burden borne by the cigarettes imported by appellants. Under the Contraband Statutes, such a wholesaler or importer would not be permitted to affix tax stamps without a manufacturer's certification of compliance with the Escrow Statute.[29]

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29. Appellants have not alleged otherwise. In their reply brief appellants conclusorily state that wholesalers "know" that cigarettes sold to them from reservations "have not been *and will not be* seized" under the Contraband Statutes. *See* Appellants' Reply Br. at 26 (emphasis added). However, appellants have made no allegations, in their complaint, in the proceedings below, or in their briefs, that, under appellees' enforcement program, cigarettes sold into New York from reservations have continued to be exempted from Contraband Statute enforcement from wholesaler to consumer. Appellants have alleged only that the Contraband Statutes are not enforced with respect to the initial sale—from the reservation to the wholesaler. *See* Compl. ¶ 3, at 3; *Freedom Holdings*, tr. at 51; Appellants' Br. at 53; Appellants' Reply Br. at 25.

In short, appellants fail to allege why the enforcement of the Contraband Statutes against off-reservation wholesalers and importers would not protect appellants from the competitive disadvantage of which they complain. Appellants make no allegations of any particular instances of enforcement or non-enforcement of the Contraband Statutes; they do not allege the means of non- enforcement, e.g., allowing sales without tax stamps, affixing tax stamps without certification, etc. At the same time, appellants have failed to identify any of the "[wholesalers and importers] located on Native American Reservations situated within the State of New York" whom they allege to have been favored by appellees, and they have not alleged that such wholesalers and importers are tobacco product manufacturers, cigarette tax stamp agents, or firms otherwise subject to the Contraband Statutes.

Appellees have therefore not been provided enough information to identify the basis for, or to defend against, appellants' claim. Under the circumstances, where the particular deficiencies that concern us were neither relied upon by the district court nor argued by appellees, appellants should be allowed a further opportunity to amend their complaint. *See Foman v. Davis, 371 U.S. 178, 181-82 (1962)* ("It is too late in the day and entirely contrary to the spirit of the Federal Rules of Civil Procedure for decisions on the merits to be avoided on the basis of [ ] mere technicalities. 'The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits.' " (quoting *Conley v. Gibson, 355 U.S. at 48)*).

We therefore remand the selective enforcement claim.

Appendix

CONCLUSION

For the foregoing reasons, we affirm the dismissal of the Commerce Clause claim, reverse with respect to the Sherman Act claim, and remand the Equal Protection claim for further proceedings.

SACK, Circuit Judge, concurring.

I concur. I write separately, however, to express some doubt about the majority's conclusion regarding the plaintiffs' claims under the Sherman Act.

The Supreme Court observed in *Parker v. Brown, 317 U.S. 341 (1943)*, that "[t]he Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state." *Id. at 351.* Therefore, "antitrust laws do not forbid the state from adopting policies that permit anticompetitive conduct by regulated private parties." *Cine 42nd St. Theater Corp. v. Nederlander Org., Inc., 790 F.2d 1032, 1042 (2d Cir.1986).*

While the Sherman Act preempts a state from "authorizing [private parties] to violate it, or . . . declaring that their action is lawful," *Parker, 317 U.S. at 351*, the Supreme Court has emphasized that "with the possible market participant exception, *any* action that qualifies as state action is *ipso facto* exempt from the operation of the antitrust laws." *City of Columbia v. Omni Outdoor Adver., Inc., 499 U.S. 365, 379 (1991)* (internal quotation marks and ellipsis omitted; emphasis in original).[1]

Where, as here, the alleged anticompetitive harm is achieved at least in part by the acts of private parties, a reviewing court

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1. *Parker* does not permit a state to "becom[e] a participant in a private agreement . . . for restraint of trade," *id.* at 351-52, but the Supreme Court has made clear that this exception applies only when the state acts as a "commercial participant in a given market," not when it acts in its "regulatory capacity," *City of Columbia, 499 U.S. at 374-75.*

must assure itself that the anticompetitive scheme is indeed that of the State itself. The court must "determine whether [the] anticompetitive conduct engaged in by private parties should be deemed state action and thus shielded from the antitrust laws." *Patrick v. Burget, 486 U.S. 94, 100 (1988).* The Supreme Court has therefore created "two standards for [such] antitrust immunity under *Parker*. . . . First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself." *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980).*

The first *Midcal* prong requires only that the state offer a "clear articulation of a state policy to authorize anticompetitive conduct." *Town of Hallie v. City of Eau Claire, 471 U.S. 34, 40 (1985).*[2]

That part of the test seems easily met here, or at least seems as though it would be capable of proof before the district court on remand. In *A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239 (3d Cir.2001)*, the Third Circuit concluded, after a discussion of the issue, that "it is evident the Multistate Settlement Agreement was backed by clearly articulated state policy." *Id. at 260* (footnote omitted). I generally agree with the Third Circuit on this point.

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2. Unlike the majority, I doubt that this test has "an ancillary purpose" of "reveal[ing] the State's purposes in agreeing to, and enforcing, the MSA's market-share provisions." *Ante at 39.* The Supreme Court has made it clear, I think, that the first prong simply "requires authority to suppress competition." *City of Columbia, 499 U.S. at 372; see also 324 Liquor Corp. v. Duffy, 479 U.S. 335, 343-44 (1987); Town of Hallie, 471 U.S. at 40-42.*

Appendix

The "clear articulation" standard is not strict. The Supreme Court, in the course of reviewing a state statute delegating the state's authority to allow anticompetitive conduct to municipalities, noted that it has "rejected the contention that this requirement can be met only if the delegating statute explicitly permits the displacement of competition, *see* [*Town of Hallie, 471 U.S. at 41-42*]. It is enough . . . if suppression of competition is the 'foreseeable result' of what the statute authorizes, *id., at 42.*" *City of Columbia, 499 U.S. at 372-73.*

> [T]he Supreme Court [has] made clear that the first prong of the *Midcal* test is not as demanding as the Court's statement of it in *Midcal* suggests. It does not, for example, require a private party to show " 'a specific, detailed legislative authorization' for its challenged conduct." [*S. Motor Carriers Rate Conf., Inc. v. United States, 471 U.S. 48, 64 (1985)*] (quoting *Lafayette v. La. Power & Light Co., 435 U.S. 389 (1978)*). Rather, "[a]s long as the State as sovereign clearly intends to displace competition in a particular field with a regulatory structure, the first prong of the *Midcal* test is satisfied." *Motor Carriers, 471 U.S. at 64.*

Elec. Inspectors, Inc. v. Vill. of East Hills, 320 F.3d 110, 124 (2d Cir.2003) (last brackets in original).

I see no reason not to apply this formulation to the case before us. And it seems to me that, thereunder, the "clear articulation" prong of the *Midcal* test can be or has been met inasmuch as the foreseeable—and likely foreseen— result of the challenged Contraband Statutes, combined with the operation

of the associated statutes and the MSA, is the suppression of competition. The second, "active supervision," prong of *Midcal* is the problem. The Third Circuit has pointed out that the MSA calls for active State supervision of the implementation of the MSA in the ordinary sense of the words "active supervision":

> The States actively and continually monitor the implementation of portions of the Multistate Settlement Agreement. After requiring a state court consent decree, the Multistate Settlement Agreement also mandates state courts to maintain continuing jurisdiction over enforcement of disputes between the States and the tobacco companies. Under the Multistate Settlement Agreement, the state courts may order compliance in the form of an Enforcement Order. If a State Attorney General believes a manufacturer has failed to comply with an Enforcement Order, it may seek an order for civil contempt or monetary sanction to force compliance. Furthermore, for a period of seven years after settlement, the Attorney General of a Settling State may inspect all non-privileged records of the tobacco companies, and will have access to interview directors, officers and employees upon reasonable belief of a violation of the Multistate Settlement Agreement.
>
> The Multistate Settlement Agreement also establishes a $50 million fund to assist the States in enforcing the Multistate Settlement Agreement. This fund is to be used to supplement the States'

> (1) enforcement and implementation of the terms of [the Multistate Settlement Agreement] and consent decrees, and
>
> (2) investigation and litigation of potential violations of laws with respect to Tobacco Products.

A.D. Bedell Wholesale Co., 263 F.3d at 261 (citations to MSA omitted). In the case before us, there similarly seems to be active State supervision, in that sense, of the Contraband Statutes, the MSA, and the other associated statutes. Indeed, the Contraband Statutes themselves may be viewed as an effort closely tied to the active supervision of the MSA, its associated State statutes, and the resulting potentially anticompetitive conduct.

But, as the Third Circuit has also noted, *id. at 260*, the Supreme Court has said that "[t]he active supervision prong of the *Midcal* test requires that state officials have and exercise power to review *particular anticompetitive acts* of private parties and disapprove those that fail to accord with state policy." *Patrick, 486 U.S. at 101* (emphasis added). The Third Circuit has applied that principle to a situation virtually indistinguishable from the one in the present case, concluding that, in the absence of state supervision of particular anticompetitive acts, the "active supervision" standard had not been met. *A.D. Bedell Wholesale Co., 263 F.3d at 261*. I agree with the majority that the district court was wrong to grant *Rule 12(b)(6)* dismissal on the Sherman Act claims because we cannot conclude at the pleading stage that the "active supervision" part of the *Midcal* test has been met. "Absent such a program of supervision, there is no realistic assurance that a private party's anticompetitive conduct promotes state policy, rather than merely the party's individual interests."

Patrick, 486 U.S. at 101. Because there is no such program of supervision reflected in what is before us, the *Parker* doctrine does not immunize the conduct of the defendants, at least not at this stage of the proceedings.

The State appears to have entered into the MSA and enacted the Escrow and Contraband Statutes as part of a comprehensive effort, *inter alia*, to settle its massive legal claims against the tobacco companies, to protect the substantial revenue promised by that settlement, and in the process, to protect State citizens (perhaps in part by driving up the price of cigarettes dramatically and erecting barriers to the success of discount cigarette importers). It is arguable that even without the particularized review called for by the Supreme Court, under the circumstances pleaded in this case, we can be confident that the scheme does not serve "merely the [tobacco companies'] individual interests," *id.*; that the "the state . . . has created the machinery for establishing" the MSA and its related statutes, *Parker, 317 U.S. at 352*, in such a way as to "effectively . . . ma[k]e [the anticompetitive] conduct its own," *Patrick, 486 U.S. at 106*. But the Supreme Court's requirement of "active supervision" in the sense in which it uses that term seems to me to foreclose a conclusion at this stage of the proceedings that the plaintiffs' Sherman Act claims are barred by *Parker*.

In any event, this action is being returned to the district court for further proceedings. During the course of those proceedings, the State may be able to satisfy both *Midcal* factors as a matter of fact.

Finally, I note the majority's comment that "the State offers no reason why it used methods suppressing competition rather

than a flat tax to achieve the same result," *ante* at 43, and that, "at this stage in the proceeding and given the allegations of the complaint, the goals of serving public health and enhancing revenue conflict. That is to say, the fewer cigarettes sold, the less threat to public health, but also the less revenue raised by the State, and vice versa." *Id.* While the majority may have identified puzzling aspects of the MSA and its accompanying statutes and the political and economic considerations that led to them, I am not convinced that these observations are relevant to our inquiry. Nothing in *Parker*, *Midcal*, or their progeny suggests to me that *Parker* immunity turns on whether a federal court understands or approves of the regulatory measures the state chooses or that the State is required to justify its decision to select a less anticompetitive course of action in place of a more anticompetitive one. I do not know why the State did not employ a flat tax instead of the scheme that it adopted, but I doubt that it matters to us so long as we are assured that the State's program is sufficiently articulated and supervised to be immune under the *Parker* doctrine.

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No. 03-806

In the Supreme Court of the United States

ROBERT MARIANA, MICHAEL J. MCFADDEN, KAREN M. MORAN, AND EDWARD M. NANKERVIS,
Petitioners

v.

GERALD J. PAPPERT, IN HIS OFFICIAL CAPACITY AS ATTORNEY GENERAL OF THE COMMONWEALTH OF PENNSYLVANIA; AND GREGORY J. FAJT, IN HIS OFFICIAL CAPACITY AS SECRETARY OF REVENUE OF THE COMMONWEALTH OF PENNSYLVANIA,
Respondents

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

SUPPLEMENTAL BRIEF OF RESPONDENTS

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DATE: January 23, 2004

ARGUMENT

Respondents file this supplemental brief to address *Freedom Holdings, Inc. v. Spitzer*, No. 02-7492, 2004 WL 26498 (2d Cir., January 6, 2004), a decision filed the day after they filed their brief in opposition to the petition for certiorari. Petitioners have addressed *Freedom Holdings* in their own supplemental brief and have described it as "in direct and complete conflict" with the Court of Appeals' decision in the case. Petitioners are wrong. There is no direct conflict, and *Freedom Holdings* is distinguishable on the facts.

In this case, the petitioners brought a direct challenge to the terms of the Master Settlement Agreement (MSA) by which the tobacco litigation brought by 46 states against tobacco manufacturers was settled. Petitioners named as defendants Pennsylvania's Secretary of Revenue and Attorney General, asking that certain provisions of the MSA be invalidated. This followed an earlier lawsuit in which similar claims were made against tobacco companies who were signatories to the MSA, but the Court of Appeals concluded in that case that the companies were shielded from antitrust liability under the *Noerr-Pennington* Doctrine. *See A.D. Bedell Wholesale Co., Inc. v. Philip Morris, Inc.*, 263 F.3d 239 (3d Cir. 2002), *cert. denied*, 534 U.S.. 1081 (2002). The Court of Appeals in this case held, as it had in *Bedell*, that the act of negotiating the MSA was petitioning activity — directed to the court — which was entitled to *Noerr-Pennington* protection, and the state officials involved were entitled to the same immunity it had earlier accorded the private participants. "If the government officials have *Noerr-Pennington* immunity for entering into the MSA, that immunity must extend to complying with

and enforcing its provisions," the Court of Appeals said. Pet. App. 17a-18a.

Freedom Holdings, by contrast, does not address a direct challenge to the petitioning activity, the Master Settlement Agreement, nor to one of the "qualifying statutes" encouraged by the MSA to neutralize the cost disadvantage experienced by participating manufacturers as a result of its provisions. Rather, the legislation challenged in *Freedom Holdings* was enacted more than three years after the MSA was executed, two years after New York's "qualifying" statute was enacted, and was not contemplated during the negotiations that led to the MSA.

In consequence, the aspect of the Court's decision in *Freedom Holdings* pertaining to the *Noerr-Pennington* Doctrine was rather cursory, and had a completely different point and focus than the Third Circuit's decision here. The Court in *Freedom Holdings*, concerned with separate legislation, holds no more than that *Noerr-Pennington* does not insulate legislation from antitrust scrutiny simply because it resulted from lobbying activity. Pet. App. to Supp. Brf. 54a-55a. For these reasons, there is no direct conflict between *Freedom Holdings* and the Court of Appeals' decision here.

Respectfully submitted,

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